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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1943

No. 620

INTERNATIONAL HARVESTER COMPANY,
Appellant,

vs.

WISCONSIN DEPARTMENT OF TAXATION.

APPEAL FROM THE SUPREME COURT OF THE STATE OF WISCONSIN.

STATEMENT AS TO JURISDICTION.

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APPEAL FROM THE SUPREME COURT OF THE STATE OF WISCONSIN.

STATEMENT AS TO JURISDICTION.

Pursuant to the provisions of Rule 12 of the Supreme Court of the United States, Appellant files this statement, showing that this Court has jurisdiction upon appeal to review the judgment in question.

This is an appeal from the judgment of the Supreme Court of the State of Wisconsin in the cause of *International Harvester Company, Appellant,* v. *Wisconsin Department of Taxation, Respondent,* reported in 243 Wis. 198, 10 N. W. 2d 169, and on rehearing in 11 N. W. 2d 95, wherein the Supreme Court of Wisconsin affirmed the order and judgment of the Circuit Court for Dane County, Wisconsin, which order and judgment affirmed an order of the Wisconsin Board of Tax Appeals which in turn had affirmed an assessment of Wisconsin privilege dividend taxes

against Appellant, International Harvester Company, a New Jersey corporation. Copy of the decision and order of the Wisconsin Board of Tax Appeals is appended hereto as Appendix A. Copy of the decision of the Circuit Court for Dane County is appended as Appendix B. Copy of the decision of the Supreme Court of the State of Wisconsin and of the opinion of the last mentioned court on rehearing are appended as Appendix C.

Copy of opinion of the Supreme Court of the State of Wisconsin in *Wisconsin Gas and Electric Company* v. *Wisconsin Department of Taxation*, a companion case to *International Harvester Company* v. *Wisconsin Department of Taxation*, is also appended as Appendix D. Copy of opinion of Wisconsin Supreme Court in *Blied* v. *Wisconsin Foundry & Machine Company*, also a companion case, is appended as Appendix E.

Basis of Jurisdiction.

Section 237 of the Judicial Code (28 U. S. C. A. 344) gives jurisdiction for this appeal. It provides that a final judgment or decree in any suit in the highest court of a state in which a decision in the suit could be had, where is drawn in question the validity of the statute of any state, on the ground of its being repugnant to the constitution of the United States, and the decision is in favor of its validity, may be reviewed by the Supreme Court by writ of error. By Act of January 31, 1928, Chapter 14, section 1 (28 U. S. C. A. 861a) the remedy by appeal has been substituted for writ of error in such cases.

The State Statute Involved.

The statute of the State of Wisconsin, the validity of which as applied to Appellant is here drawn in question, known as the Wisconsin Privilege Dividend Tax Act, is

section 3 of Chapter 505, Laws of 1935, as amended by Chapter 552, Laws of 1935, and Chapters 233 and 309, Laws of 1937. It was published and became effective September 26, 1935. The pertinent provisions of the Act, in effect from date of enactment through 1937, appearing under section 71.60, page 1040, Wisconsin Statutes of 1937, are as follows:

"SECTION 3. PRIVILEGE DIVIDEND TAX. (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to 2½ per cent of the amount of such dividends declared and paid by all corporations (foreign and local), except those specified in paragraphs (d) and (g) of subsection (1) of section 71.05 of the statutes, after the passage and publication of this act and prior to July 1, 1939. Such tax shall be deducted and withheld from such dividends payable to residents and non-residents by the payor corporation.

(2) Every corporation required to deduct and withhold any tax under this section shall, on or before the last day of the month following the payment of the dividend, make return thereof and pay the tax to the tax commission, reporting such tax on the forms to be prescribed by the tax commission.

(3) Every such corporation hereby made liable for such tax, shall deduct the amount of such tax from the dividends so declared.

(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to this state shall be computed in accordance with the provisions of chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such cor-

poration attributable to Wisconsin under the provisions of Chapter 71, for the year immediately preceding the payment of such dividend. If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state.

. . . . . .

(7) For the purposes of this section dividends shall be defined as in section 71.02, except that the tax herein imposed shall not apply to stock dividend or liquidating dividends.

(8) The tax hereby levied, if not paid within the time herein provided, shall become delinquent and when delinquent shall be subject to a penalty of two per cent on the amount of the tax and interest at the rate of one-half per cent per month until paid.

. . . . . .

(10) Except as they are inconsistent with this section, the provisions of paragraph (b) of subsection (3) of section 71.06, sections 71.10 to 71.17, inclusive, subsection (3) of section 71.18, sections 71.36 and 71.37 of the statutes shall apply to the tax imposed by this section, but the discount provisions of paragraph (c) of subsection (3) of section 71.10 shall not apply."

Date of Judgment Sought to Be Reviewed and Date of Presentation of Application for Review.

The date of the final decision (on motion for rehearing) and judgment of the Supreme Court of the State of Wisconsin sought to be reviewed is September 14, 1943. The original judgment and decision of the Supreme Court of Wisconsin was rendered June 16, 1943.

The petition for appeal to the United States Supreme Court was presented to and allowed by Hon. Marvin B.

Rosenberry, Chief Justice of the Supreme Court of Wisconsin, on December 11, 1943.

Finality of Judgment.

The Supreme Court of Wisconsin is the highest court of the State of Wisconsin, and on its denial of the motion for rehearing its judgment became final. Under the constitution of Wisconsin the Supreme Court of Wisconsin is the court of last resort in the state (Constitution of the State of Wisconsin, Art. VII, Sec. 3).

The United States Supreme Court has held that the date from which the time for making application for appeal begins to run is the date, if a petition for rehearing is filed, when the petition for rehearing is denied. *Citizens Bank of Michigan City v. Opperman*, 249 U. S. 448, 449, 63 L. Ed. 701; *Gypsy Oil Co. v. Leo Bennett Escoe* (572), 275 U. S. 498, 499, 72 L. Ed. 393.

Nature of the Case.

This appeal involves, *in the light of new developments in the application of the law*, (1) the validity of the Wisconsin Privilege Dividend Tax Act (set forth at page 17 hereof) as applied in assessments against Appellant, a New Jersey corporation, in respect to the exercise, wholly outside of Wisconsin, of the privileges of "declaring and receiving" dividends between October 7, 1935, and October 15, 1937; (2) the validity of that law as applied to such dividends declared and paid by Appellant out of income accumulated prior to the date of the enactment of the law; and (3) whether the use of the formula for ascertaining the tax, newly devised and here applied by the Wisconsin Department of Taxation, denies due process of law.

The Wisconsin Privilege Dividend Tax Act imposes a tax at the rate of 2½% (now 3%) "for the privilege of

declaring and receiving dividends out of income derived from property located and business transacted in" Wisconsin. This tax is imposed on dividends declared and paid by all corporations, foreign and local (with exceptions not here pertinent). The Act was to "take effect upon passage and publication" on September 6, 1935; it was applied by way of assessment in respect to all dividends declared and paid by Appellant subsequent to such date, notwithstanding a substantial part of the so-called Wisconsin surplus (accumulated Wisconsin income) from which such dividends were declared and paid had been accumulated prior to the enactment of the law. (Rec. 147).

Since January 1, 1936, Appellant has been admitted to do business in every state of the Union, except Nevada. It had manufacturing plants and sales branches in many states. The proceeds of all sales and receipts from its operations and business went to Appellant's treasury department in Chicago, Illinois, and were there commingled without segregation or ear-marking, in the general funds of the corporation. (Rec. 129).

Every act and proceeding in respect to the declaration and payment of all dividends in question took place in Chicago, Illinois, where Appellant's Board of Directors met and declared them and where Appellant's treasury department drew and mailed dividend checks on Appellant's bank accounts representing its general funds on deposit in Chicago and New York. (Rec. 130, 131). Such dividend checks were there mailed to Appellant's many stockholders, of whom during the period in question there were more than 32,000 in every state of the United States and many foreign countries. Less than 2% of Appellant's stockholders were residents of Wisconsin. (Rec. 131, 150).

Appellant had outstanding both common stock and preferred stock on which it paid dividends quarterly. (Rec. 129). Appellants's dividends were not charged against the

earnings or profits of any particular class or period, but were charged against surplus which resulted from and reflected the accumulated net profits and income from property wherever located and business wherever transacted (Rec. 131). Appellant's charter state is New Jersey, and the applicable laws of that state permit directors of a corporation to pay dividends only from its surplus or from the net profits arising from the business of the corporation, which has been held to be the same as surplus (Rec. 128, 129).

In prescribing the method for determining the amount of "dividends declared and paid out of income derived from property located and business transacted within the State of Wisconsin" by a corporation doing business within and without the state the Dividend Tax Act prescribed that "the amount of income attributable to this state shall be computed in accordance with the provisions of Chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of Chapter 71, for the year immediately preceding the payment of such dividend." Chapter 71, which is the Wisconsin Income Tax Law, prescribes the method for determining taxable income of a corporation engaged in business within and without the state, and in that respect requires attribution of certain non-apportionable income, and the apportionment of the balance on the basis of the arithmetical average of three fractions representing, respectively, the ratios of tangible property, of cost of manufacturing, and of sales in Wisconsin to the total of each. (Sec. 71.02(3) (d) Wis. Stats.)

The Wisconsin Supreme Court, on remand of the *J. C. Penney* case from this court, (*J. C. Penney Co. v. Wisconsin*, 238 Wis., 69, 78, 298 N. W., 186), found that the Penney Company had paid its dividends out of surplus as of the

end of the prior year rather than from income of that year, and thereupon declared that, "It must be presumed, however, that when it (the Company) drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935, but to the whole amount of the surplus." Accordingly, and solely upon the authority of the above quoted language of the Wisconsin Supreme Court, the Wisconsin Department of Taxation proceeded to compute the Wisconsin Privilege Dividend taxes against Appellant on a new formula not provided in the statute (Rec. 144).

It found for each year the percentage of Appellant's net income subject to Wisconsin *income tax*. This was found under the formula specified in Chapter 71, the Income Tax Chapter. It applied that percentage to the Appellant's *book income* for the same year (Rec. 113, 149). Book income, of course, is a very different figure, from taxable income. For one thing, reserves are deducted in arriving at book income which cannot be deducted in arriving at taxable income.

By this method, the Department found the *book income* of Appellant derived from Wisconsin in the year in question. This *book income* derived from Wisconsin, was accumulated from year to year. The amount so accumulated was called Wisconsin earnings reflected in *surplus*. When a dividend was declared the Department estimated that so much of the dividend was derived from Wisconsin earnings as was found by applying to the dividend the ratio obtained by dividing so-called Wisconsin earnings reflected in surplus by total surplus (Rec. 113, 149).

The result was taxed at 2½% (Rec. 146).

The only method prescribed by the statute would have required the Department to apply to the amount of the dividend the income tax fraction of the previous year ob-

tained as the arithmetical average of the ratios of Wisconsin property to total property, Wisconsin sales to total sales, and Wisconsin cost of manufacturing to total cost of manufacturing.

The Wisconsin Department of Taxation included in total surplus on which the tax was calculated, Appellant's surplus at the end of the year 1934, preceding the date (September 26, 1935) of the enactment of the Privilege Dividend Tax, amounting to $803,780.72. This figure had been increased by December 31, 1935, following the enactment of the law, to $2,227,499.03 (Rec. 147). It follows that Appellant's surplus of $803,780.72, plus so much of the 1935 increase of $1,423,718.31 as had been accumulated before September 26, 1935, was surplus accumulated prior to the enactment of the Wisconsin Privilege Dividend Tax Law.

On the foregoing basis the Wisconsin Department of Taxation applied and assessed against the Appellant the 2½% on its dividends declared and paid between December 2, 1935, and October 15, 1937. The tax amounted to $53,713.29, to which there was added penalties and interest to January 1, 1942, of $16,735.60, bringing the aggregate tax, interest and penalties to $70,088.89, all of which are involved on this appeal (Rec. 146, 167). The assessment was made against Appellant after its payment of the dividends to which applicable, and was paid by Appellant under protest. No part of the tax was withheld from dividends. This suit was brought to obtain refund of the amount so paid.

On this factual basis the Wisconsin Supreme Court affirmed the assessments of privilege dividend taxes against Appellant.

The consequences of such tax are important, first, as to the very substantial tax heretofore paid by Appellant, and not deducted from dividends, and directly involved on this appeal; and, second, any future taxes, which the Wisconsin

Supreme Court now holds may not be absorbed by the corporation, but must be withheld from each dividend. Such withholding would necessarily involve heavy expense and loss of good will of stockholders. The tax on a quarterly dividend of $.625 per share on common stock in 1937 on even twenty shares would have been only $.01825 (2½% tax on 5.8% of dividend of $12.50) (Rec. 147). There were 32,000 stockholders. This calculation would have to be made four times a year (for each quarterly dividend) for each stockholder. Loss of good will of stockholders, residents of other states from Maine to California and of foreign countries, critically demanding explanation as to why their dividends had been nicked for Wisconsin taxes, would be incalculable.

The first two issues in this case, (1) as to the validity of the Dividend Tax Act as against foreign corporations and their nonresident stockholders, exercising the privilege of "declaring and receiving dividends" outside of Wisconsin, and (2) the validity of the law as applied to dividends from income accumulated prior to enactment of the law, grow out of the divergent views of the Wisconsin Supreme Court and of this Court as to the nature of the tax and the incidence thereof.

(a). *The issue involving validity of the Privilege Dividend Tax Act as to foreign corporations and their non-resident stockholders.*

The decision of this Court in Wisconsin v. *J. C. Penney Co.*, 311 U. S., 435; 85 L. Ed., 267, *is not controlling here.* Since the decision of this Court in the *Penney* case there have been vitally important determinations with respect to the Wisconsin Privilege Dividend Tax which make the issues presented on this appeal radically different from those presented to this Court in the *Penney* case. Since

this Court's decision in the *Penney* case, the Wisconsin Supreme Court has held explicitly:

1. That the Privilege Dividend Tax can in *no sense* be considered an additional *tax on corporate income.*

2. That the tax is on the *stockholder* and must be withheld from *his dividend.*

3. That the tax cannot be deducted as a business expense by the corporation.

4. That the tax cannot be considered as an income tax on *non-resident stockholders,* and as such would be invalid under the Wisconsin Constitution.

5. That the formula to be used for ascertaining the tax where, as here, the dividend was paid from surplus, must be entirely different from that considered by this Court in the *Penney* case. (The formula considered by this Court in that case was the Wisconsin statutory income tax formula. To meet objections to the statutory income tax formula, the Wisconsin Department of Taxation devised the formula actually applied in determining Appellant's tax.)

All agree that mere labels are not "instruments of adjudication." This Court has stated: "for constitutional purposes the decisive issue turns on the operating incidence of the challenged tax". (*Wisconsin* v. *J. C. Penney Company,* 311 U. S. 435, 444, 85 L. Ed. 267, 270).

Consequently the real nature of the tax, regardless of labels, and the operating incidence of that tax, are fundamental in this case. We look, therefore, to the latest exposition by the Wisconsin Supreme Court.

The Wisconsin Supreme Court, in the instant case, recognizing that "This case is another chapter in the long history of litigation concerning the dividend tax law", noted that in an early chapter, i. e., in *J. C. Penney Company* v. *Tax Commission,* 233 Wis., 286; 289 N. W., 667, it had held that

as applied to a foreign corporation doing business in Wisconsin and deriving a portion of its surplus from net earnings in Wisconsin,

> "the law was an unconstitutional attempt by Wisconsin to tax a privilege which it neither gave nor protected, and that Wisconsin was consequently without jurisdiction to levy the tax" (P. 203).

For that holding the Wisconsin court had relied principally on the case of *Connecticut General Insurance Company* v. *Johnson*, 303 U. S. 77, where, as the Wisconsin court now says, "upon facts that appeared to us to be quite indistinguishable the Supreme Court of the United States had held California to be without jurisdiction to levy a privilege tax."

The Wisconsin Supreme Court (in the instant case) went on to note the next chapter in the litigation, the appeal to this Court, where as the Wisconsin court said:

> "Judgment in the *Penney* case was reversed by a divided court. It was held [by the United States Supreme Court] that the practical operation of the legislation is to impose an additional tax upon corporate earnings within Wisconsin, but to postpone the liability for this tax until such earnings are paid out in dividends" (P. 203).

The Wisconsin court recognized that this Court in the *Penney* case had taken notice of the Wisconsin court's determination that the tax was "upon a transaction wholly beyond Wisconsin's borders or reach", but had stated the inquiry to be whether Wisconsin had "transgressed its taxing power because its Supreme Court has described the practical result of the exertion of that power by one legal formula rather than another—has labeled it a tax upon the privilege of declaring dividends rather than a supplementary income tax." This inquiry, it was stated by the

Wisconsin court, was resolved by this Court's determination that:

> "For constitutional purposes the decisive issue turns upon the operating incidence of a challenged tax. A state is free to pursue its own fiscal policies, unembarrassed by the Constitution, if by the practical operation of a tax the state has exerted its power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred by the fact of being an orderly, civilized society" (P. 204).

The next chapter in the litigation, noted by the Wisconsin Supreme Court, was upon the remand of the *Penney* case when, in the language of the Wisconsin court in the instant case, that court, *"(1) insisted upon its exclusive power to construe the law; (2) held the law to be a privilege tax and not an income tax; (3) held that the determination of the United States Supreme Court settled all questions as to the jurisdiction of Wisconsin to levy the tax, whatever it be called, and (4) made certain directions as to its computation."* (See Appendix C hereof, pages 64, 69) (243 Wis. 198, 205).

Between these divergent views as to the nature of the Wisconsin privilege dividend tax, that is, the United States Supreme Court's view that this was an income tax (notwithstanding the Wisconsin court had declared it was in no sense an income tax against the corporation and that considered as an income tax against non-resident stockholders it would be invalid under the Wisconsin Constitution) and the view of the Wisconsin Supreme Court that this was a privilege tax (which, being upon a privilege wholly exercised outside the state, would be unconstitutional under the Federal Constitution), the Wisconsin Supreme Court, unlike the trial court, saw no dilemma. (Cf. opinion of trial court, Appendix B hereof, page 54.) The Wisconsin Supreme Court assumed to resolve the supposed dilemma by

declaring that this Court had established "as the jurisdictional fact" upon which the Wisconsin jurisdiction to levy the tax is predicated, "that the corporation paid the dividends in whole or in part out of property located in this state, or business transacted here. • • • That the basis of Wisconsin's power to tax is the fact that it has given its protection and the benefits of government to corporate activities in Wisconsin and that profits from this activity are traceable to the fund from which dividends are paid." In this aspect the Wisconsin court put aside the privilege feature of the law, saying "so far as the constitutional aspects of the cases are concerned, the Supreme Court has reduced the privilege feature of the tax to mere conditions or contingencies upon the happening of which the tax accrues."

While perceiving no conflict, "so long as we are talking about the power of Wisconsin to tax as against the contention that the subject of the tax is beyond her borders and hence beyond her jurisdiction", the Wisconsin court resolutely reiterated its position thus:

> "We adhere to our determination upon remand of the *Penney* case that this is a privilege tax and that we are bound to accept the mandate of the Supreme Court that its constitutional justification from the standpoint of Wisconsin power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend. • • • The constitutional question considered material and decided by this court in the original *Penney* case involved the Federal Constitution and has been answered by the Supreme Court."

Decided by the Wisconsin Supreme Court on the same day as this case were the companion cases, *Wisconsin Gas & Electric Company* v. *Wisconsin Department of Taxation*, 243 Wis., 216, 10 N. W. 2d, 140, and *Blied* v. *Wisconsin De-*

partment of Taxation, 243 Wis., 221, 10 N. W. 2d, 142, involving, from quite different aspects, the precise question as to whether the Wisconsin privilege dividend tax was upon the corporation, or upon the stockholders. In the case first mentioned, which was held to control the second case, the Wisconsin Supreme Court said:

> "The real question in this case is: on whom is the actual burden of this tax laid? This question can have but one answer. The statute specifically puts it upon the stockholder. The corporation is directed to deduct the tax from the dividends and if it does as it is required to do, it sustains no expense and consequently may not, in any event, deduct the tax from its gross income. It is contended that the foreign stockholder of a foreign corporation has done no business in Wisconsin for which the tax may validly be levied. This contention was foreclosed when the Supreme Court of the United States sustained the power of Wisconsin to levy this tax. It made its determination with the statute before it—a statute that plainly puts the burden of this tax upon the stockholder and not upon the corporation. So far as Wisconsin's power to reach beyond its borders and to levy the tax is concerned, the Supreme Court has declared that Wisconsin has the right to exact the tax because of protection given to corporate activities in this state resulting in earnings traceable to the dividends declared and benefits to the stockholder who has received a dividend. * * * That power (of this state to impose this very tax) having been sustained, *regardless of what the tax be called or where its burdens may be considered to fall*, it is immaterial that the Supreme Court has not merely regarded the privilege features of the tax as unimportant but has to some extent disregarded the corporate entity in view of the real benefits conferred by the state upon the stockholder. We are certain of three things: (1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the

dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the *Penney* case. It follows that appellants' contentions must fail." (Emphasis ours.)

For fuller expression of that determination so steadfastly adhered to, "that this is a *privilege tax*", *against the stockholder*, in contrast to a "supplemental *income tax*" *against the corporation*, we quote from the Wisconsin court's unanimous opinion on remand of the *Penney* case:

"As we understand the law our construction of the state statute is conclusive upon the supreme court of the United States. • • • If there has been a shifting of labels in this case, it was not done by this court. It is perfectly true that the tax cannot be sustained as an income tax under the law of this state. Under our constitutional amendment authorizing the levying of an income tax, sec. 1, art. VIII, Const., it has been consistently held that an income tax is a burden laid upon the recipient of an income and the amount of the tax is measured by the amount of the income. • • • Under its laws this state cannot and it does not undertake to tax the income of citizens of other states who are not doing business in this state. Under the terms of the statute under consideration no tax is levied until a dividend is declared. When the dividend is declared the dividend belongs to the stockholder. It is a debt of the corporation for the recovery of which the stockholder may maintain an action. Inasmuch as the tax cannot be levied until the dividend is declared if it is not a tax on the privilege of declaring and receiving a dividend *as we hold it to be*, then it must be a tax on the recipient, a person not engaged in doing business in this state nor a resident thereof. *In no sense and to no extent whatever is it a tax upon the income of the corporation.*" (Emphasis ours.) (238 Wis., 72-73, 298 N. W., 188)

(b) *The issue as to validity of the Dividend Tax Act as applied to dividends from income accumulated prior to enactment of the law.*

The second issue, not heretofore presented or passed upon by this Court, is whether, if valid at all, the Wisconsin Privilege Dividend Tax Act, within the principles of due process under the Federal Constitution, may be sustained to impose a tax upon dividends declared and paid after the enactment of the law, but from income derived and accumulated by the corporation over an indefinitely long period prior to the enactment of the law. Here again the fundamental issue depends upon a determination as to the nature of the tax, whether grounded upon "the substantial privilege of carrying on business in Wisconsin" granted by the State to the corporation, or whether based solely upon the privilege of declaring and receiving dividends.

The Wisconsin Supreme Court in the instant case held that it was apparent the legislature meant to levy the tax on dividends paid out of net corporate earnings "without regard to the year or years during which the earnings accrued", but the court was evenly divided on the issue as to the validity of the law in that respect, three Justices being of the opinion "that since this is a privilege tax on transactions by which dividends are paid subsequent to the enactment of the statute, the tax is prospective and not retroactive in operation when it [the tax] is imposed on only such of those transactions as occurred in the year in which it is imposed", and three Justices being of the view:

> "(1) that since the United States Supreme Court has held that the label placed upon this law by the legislature or by this court is wholly ineffective to impair its constitutionality as against the contention that Wisconsin is without power to levy the tax, such label or designation, or the selection by Wisconsin of the payment and receipt of the dividend as the occasion for

the tax, is equally ineffective to save it from objections to its retroactivity; (2) that the earnings of the corporation in Wisconsin upon which are grounded Wisconsin's power to levy the dividend tax must be within reach of a retroactive tax; (3) that the extent of permissible retroactivity should be determined upon the analogy of the income tax cases; (4) that retroactivity should only be permitted to 'recent' transactions; (5) that consistently with these principles the tax may not be applied to earnings in Wisconsin which accrued prior to the last corporate fiscal year preceding the enactment of Wisconsin privilege dividend tax; (6) that by reason of the severability clause, the operation of the tax should be so limited; (7) that nothing in the decision upon remand requires a different conclusion." (P. 208)

One Justice, Mr. Justice Barlow (who had been Tax Commissioner at the time of the assessments in question) did not participate in the decision of the case. Because the Justices participating in the decision on this issue were equally divided, the judgment of the lower court and the assessment of the tax were affirmed.

The "analogy to the income tax cases" adopted to sustain the views last quoted in favor of a "permissible retroactivity" to "recent transactions" is found in *Welch* v. *Henry*, 223 Wis. 319, 271 N. W. 68. On appeal to this Court that case was affirmed (*Welch* v. *Henry*, 305 U. S. 134, 83 L. Ed. 87), but as will be shown under a subsequent heading of this Statement, limitations there expressed by this Court upon the permissible retroactivity of tax legislation, as compared even with the view of those three Justices of the Wisconsin court who would have denied the retroactive operation of the law only to dividends from "earnings in Wisconsin accrued prior to the last corporate fiscal year preceding enactment" of the law, present a substantial federal question. Even more substantial is

the federal question presented by the affirmance (by the evenly divided court) of the assessments upon dividends without any regard to length of the period prior to enactment of the law during which the earnings had accrued.

Upon the question as to the permissible retroactivity of such a tax law, if valid at all, one of the factors considered by this Court is the novelty of the tax. It is at once apparent that there had never been a precedent for the Wisconsin Privilege Dividend Tax. Whether regarded as grounded upon the privilege granted to the corporation to do business in the state or upon the privilege of declaring and receiving dividends, there never had been in Wisconsin, or any other state so far as we know, any such tax upon non-resident stockholders of a foreign corporation authorized to transact business in the state. Such a tax could not reasonably have been anticipated at any time before the legislative process actually began. Thus even the analogy of the income tax cases, where permissible retroactivity has been extended to the tax year preceding the enactment, would not justify retroactivity here to cover even the last fiscal year preceding the date of the enactment, that is, the distribution of income earned by Appellant on and after January 1, 1934 (the law having taken effect on September 26, 1935).

(c) *The issue involved in the adoption of a formula for determining the basis of the Privilege Dividend Tax not specified by the Act.*

The third issue, also not heretofore presented to or passed upon by this Court, is whether the assessments made by the Wisconsin Department of Taxation, on a formula not provided for by the statute, are a denial of due process of law under the Fourteenth Amendment of the Federal Constitution.

We have explained above (p. 7) the method adopted by the Wisconsin Department of Taxation after the Supreme Court of Wisconsin on remand of the *Penney* case from this Court held that the income tax fraction prescribed by the statute could not be applied when the dividend was paid not out of current earnings but out of surplus. The formula adopted by the Department is vitally different from the statutory formula. To find the portion of the year's income derived from Wisconsin it applies the income tax fraction each year not to taxable income as is done under the income tax chapter, but to *book income*, a very different figure. When a dividend is paid it taxes, as having been derived from Wisconsin, that proportion of the dividend which the amount of the accumulated *book* earnings from Wisconsin (so-called Wisconsin earnings reflected in surplus) bears to the entire *book* surplus. This notwithstanding the Wisconsin Privilege Dividend Tax Law provides that the portion of the dividend derived from Wisconsin shall be determined in accordance with the provisions of Chapter 71, the Income Tax Chapter.

Chapter 71 provides that unless a separate allocation is made, the amount of the dividend derived from Wisconsin shall be allocated on the basis of the income tax formula explained above. It provides no alternative formula.

The third question presented on this appeal arises from the use of this formula devised by the Wisconsin Department of Taxation and not provided for in the Income Tax Chapter nor in the Privilege Dividend Tax Law. It raises the question whether the use of an unauthorized formula does not deny Appellant due process of law under the Fourteenth Amendment of the Federal Constitution.

The Federal Questions Involved Are Substantial.

(a) *The substantial question remaining in respect to validity of the Privilege Dividend Tax Act as against foreign corporations and their non-resident stockholders.*

The substantial importance of the federal questions here involved is at once apparent upon considering the diverse decisions of the lower federal courts, depending on whether they adhered to the construction of the Privilege Dividend Tax Act announced by the majority of this Court in the *Penney* case or whether they accepted the construction placed upon the law by the Wisconsin Supreme Court.

Thus the Federal District Court for the Eastern District of Wisconsin, in *Wisconsin Gas & Electric Co.* v. *U. S.*, 46 Fed. Supp. 929 (1942), considered whether, for federal income tax purposes, the corporation was entitled to take deduction of the Wisconsin privilege dividend tax. That court compared the majority and the minority opinions in the *Penney* case, and said:

> "We would be strongly inclined to agree with the opinion expressed by the minority, but are bound to follow the conclusion of the majority opinion, which states at page 442 of 311 U. S. at page 248 of 61 S. Ct.; '* * * The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this tax until such earnings are paid out in dividends. In a word, by its general income tax Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out.'
>
> These words of the majority opinion cannot be lightly brushed aside. On this point there was a direct and emphatic conflict with the viewpoint of the minority. If the Wisconsin privilege dividend tax 'is to impose an additional tax on corporate earnings', and if 'by the Privilege Dividend Tax of 1935 Wisconsin super-

imposed upon this income tax a tax on corporate income that is paid out', then there can be little doubt but that the majority of the Supreme Court held the tax to be on the corporation and not upon the shareholders. It is apparent that the validity of the tax was upheld on that basis.". P. 930.

This case was appealed by the Government to the Circuit Court of Appeals, Seventh Circuit, but pending such appeal the Wisconsin Supreme Court rendered its decision in the instant case and the companion cases of *Wisconsin Gas & Electric Company* v. *Wisconsin Department of Taxation* and *Blied* v. *Wisconsin Foundry & Machine Company.* (For opinions see Appendix D and E hereof.) In view of those decisions of the Wisconsin court, the Circuit Court of Appeals reversed the District Court and held that the corporation was not entitled, in determining its federal income tax, to deduct the Wisconsin privilege dividend tax. (*Wisconsin Gas & Electric Co.* v. *U. S.*, 138 Fed. 2d — (Nov. 8; 1943.)) The Circuit Court of Appeals considered that the issue "depends upon whose burden it is to pay this tax," found that subsequent to this Court's decision in the *Penney* case, the Supreme Court of Wisconsin had answered the question as to where this burden rests, and quoted the Wisconsin court's conclusion:

> "We are certain of three things: (1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the Penney case."

The Circuit Court of Appeals thereupon concluded:

> "Thus, it will be seen that the Supreme Court of Wisconsin has decided very clearly that *the burden of*

this tax is upon the stockholder and not upon the corporation, and that it was not an expense of the corporation." (Emphasis ours)

The Circuit Court of Appeals recognized that at the time the District Court decided the case the Wisconsin Supreme Court had not decided *Wisconsin Gas & Electric Co.* v. *Wisconsin Department of Taxation*, or *Blied* v. *Wisconsin Foundry and Machine Co.*, supra, but had relied on *Wisconsin* v. *J. C. Penney Co.*, 311 U. S., 435; and of this the court said:

> "The reasoning of that case would seem to sustain the District Court's position."

Further illustration of the contrary result consequent upon following the view expressed by the majority of this court in the *Penney* case, is found in the decision of the Tax Court of the United States in *Montreal Mining Company* v. *Commissioner*, decided September 16, 1943, hence subsequent to the Wisconsin court's decision above noted, but prior to the decision in the *Wisconsin Gas & Electric Company* case. As in the *Wisconsin Gas & Electric Company* case there was involved the deductibility of the Wisconsin privilege dividend tax. The Commissioner contended that the privilege dividend tax is a levy upon the stockholders and consequently should be disregarded entirely in the taxation of the corporation's income. On this issue the Tax Court said:

> "The Supreme Court, in *Wisconsin v. J. C. Penney Co.*, 311 U. S., 435, considered the Wisconsin privilege dividend tax in connection with a constitutional question. In discussing the statute imposing such tax the Court said:
>
> * * * The practical operation of this legislation is to impose an additional tax on corporate earnings within Wisconsin but to postpone the liability for this

> tax until such earnings are paid out in dividends. In a word, by its general income tax Wisconsin taxes corporate income that is taken in; by the Privilege Dividend Tax of 1935 Wisconsin superimposed upon this income tax a tax on corporate income that is paid out.
>
> Thus, it is apparent that the tax in question was there determined to be a levy on corporate income. Upon the authority of that decision, we hold in petitioner's favor on this issue. The tax is deductible under section 23 (c) of the Revenue Acts of 1934 and 1936."

In the light of the now explicit and authoritative construction of the Wisconsin Privilege Dividend Tax Act by the Wisconsin Supreme Court, that it is a privilege tax imposed against the stockholders, application of the principles laid down by this court in *Connecticut General Ins. Co.* v. *Johnson*, 303 U. S. 77, 82 L. Ed. 673, and never retracted, not only presents a most substantial federal question, but compels the striking down of the Wisconsin privilege dividend tax law insofar as it is an attempt by Wisconsin to tax transactions of citizens of other sovereign states living outside her boundaries and regulated by the law of the state of domicile or residence. In that case a Connecticut Life Insurance Company did business in California under license from that state. It entered into contracts with other insurance companies, also licensed to do business in California, reinsuring them against loss on policies written by them in California on the lives of California residents. The contracts were made in Connecticut, premiums were paid there, and the losses were there payable. California imposed a tax upon the privilege of the company to do business within California, measuring the tax by the gross premiums received. California officials attempted to collect the tax on premiums received by the Connecticut corporation under the reinsurance contracts in question, and

the Supreme Court of California sustained the tax. In the *Penney* case the majority, distinguishing the *Connecticut General Life Insurance Company* case, said that in the precise circumstances presented by the record in that case "it was found that the tax neither in its measure nor in its incidence was related to the California transactions."

Now the authoritative construction of the Wisconsin law by the Wisconsin court establishes that, *as applied to foreign corporations, and their non-resident stockholders, the Wisconsin tax, both in its incidence and in its measure, is related to transactions outside of Wisconsin.* It is a tax against the non-resident stockholder measured by and subtracted from his right to receive payment of dividends declared and paid outside of Wisconsin and under the sanction of laws of sister states. The principle of the *Connecticut General Insurance Co.* case is, therefore, directly applicable.

In *Provident Savings Life Assurance Society* v. *Kentucky*, 239 U. S. 103, this Court considered a Kentucky privilege tax on a life insurance company which previously had carried on a life insurance business in the state, still continued its contracts on the lives of Kentucky residents, but had withdrawn from Kentucky and thereafter collected premiums on its Kentucky contracts at its home office in New York. In holding that Kentucky could not lay a privilege tax against the Company this Court said:

> "Taxation without jurisdiction has been held to be a violation of the Fourteenth Amendment (*Louisville & J. F. Co.* v. *Kentucky*, 188 U. S. 385; *Delaware L. & W. R. Co.* v. *Penn.*, 198 U. S. 341; *Union Ref. Transit Co.* v. *Kentucky*, 199 U. S., 194); and the principle involved applies to the assertion of authority on the part of the state to exact a license tax for the privilege of doing acts which lie beyond the sphere of local control." (P. 112)

And continuing, at pages 113 and 114:

> "As a privilege tax the tax rests upon the assumption that what is done depends upon the state's consent. But the continuance of the contracts of insurance already written by the company was not dependent on the consent of the state. * * * Neither the continuance of the obligation itself nor acts done elsewhere on account of it can be regarded within the state's control."

We have accepted as well established the principle that the construction which the Wisconsin court has placed upon the Wisconsin Act in respect to the nature of the tax and its incidence is final and binding on the United States Supreme Court. That principle was asserted by the Wisconsin Supreme Court in *J. C. Penney Co.* v. *Tax Commission*, 238 Wis. 69, 72, 298 N. W. 186, 188. That view was accepted by the Circuit Court of Appeals in *Wisconsin Gas & Electric Co.* v. *United States*, 138 Fed. 2d (Nov. 8, 1943). It, therefore, should be observed that insofar as this Court, in the *Penney* case, construed the Wisconsin law as imposing a supplemental income tax upon the corporation, as distinguished from a privilege tax against the stockholder, as it had been previously characterized in that case by the Wisconsin Supreme Court, this Court assumed a prerogative which is inconsistent with our constitutional system of government. No doubt the United States Supreme Court may examine for itself, and place its own construction on a state law, and in so doing may overrule the construction placed upon the law by the state court, in order to *strike down* the state statutes *as an encroachment* upon rights guaranteed by the Federal Constitution. This authority of the United States Supreme Court to correct judgments of state courts necessarily is inherent in the duty of the United States Supreme Court to prevent encroachment upon the Federal Constitution or the invasion of rights guaranteed by the

Federal Constitution. It is not, however, a function of the United States Supreme Court to review the judgments of state courts for the correction of errors *generally*. Until this Court's decision in the *Penney* case there was, so far as we are aware, no precedent in which the United States Supreme Court had overruled the highest court of a state in respect to the construction of a state law for the purpose or with the result of *sustaining* the state law. The distinction is vital.

In *Phoenix Insurance Co.* v. *Gardiner*, 78 U. S., 204, 206; 20 L. Ed., 112, the Court said:

> "* * * Now, we have repeatedly held that the construction of state statutes belongs to the state courts, and is not a Federal question which we can revise in a writ of error to a state court. It is true, if the state court gives such a construction to a state statute as to make it conflict with the Constitution or laws of the United States, and sustains its validity after giving it such construction, and thereby deprives a party of his rights under the said Constitution or laws, then a Federal question is raised, and we can review the decision on the point of the validity of the statute. * * *."

In *Erie R. R. Co.* v. *Tompkins*, 304 U. S. 64, 79; 82 L. Ed. 1188, 1194, the Court quoted with approval:

> "'* * * Supervision over either the legislative or the judicial section of the States is in no case permissible except as to matters by the Constitution specially authorized or delegated to the United States. Any interference with either, except as thus permitted, is an invasion of the authority of the State and, to that extent, a denial of its independence.'"

In *Rawlins* v. *Georgia*, 201 U. S., 638, 639; 50 L. Ed. 899, 900, it was said:

> "If the State Constitution and laws as construed by the state court are consistent with the Fourteenth Amendment we can go no further."

True, the opinion of this Court in the *Penney* case declared that "ascertainment of the scope of the exaction—what is included in it—is for the state court." However, this statement of principle appears not to have been honored by the Court in holding, contrary to the Wisconsin court's declaration, that this was a supplemental income tax on the corporation and as such was within the power of the state to impose. It may be said in explanation of this seeming failure of this Court to give full credit to the State court's construction of the law, that the Wisconsin Supreme Court had not at that time, as it has since in the instant case, fully and explicitly declared that the incidence of the tax is upon the stockholder. Until the questions as to the practical operation of the law were presented in this and the companion cases which were considered and decided at the same time, the Wisconsin court had not been required to pass upon the incidence of the tax.

Whatever may be the true principle to be deduced from the majority opinion of this Court in the *Penney* case, it is evident from the minority opinion in that case that the four dissenting members of this Court considered that in determining the nature and incidence of the tax in question the majority had disregarded the construction placed upon the law by the state court. It is evident too that on remand of the *Penney* case the Wisconsin Supreme Court, though compelled on the whole to accept the determination of this Court as to the state's power to tax, considered that this Court had refused to accept the Wisconsin court's determination as to the nature of the law and the incidence thereof. The District Court for the Eastern District of Wisconsin, in *Wisconsin Gas & Electric Co.* v. *United States*, *supra*, confronted by the "direct and emphatic conflict" between the majority opinion and the minority opinion of this Court in respect to the *nature* and the *incidence* of the tax, was constrained to accept the majority opinion,

but on appeal in that case the Circuit Court of Appeals has accepted as the authoritative determination of these two pivotal considerations the most recent determination of the Wisconsin Supreme Court in the instant case. Upon the foregoing, we submit that the decision of this Court in the *Penney* case has given rise to contrary views in respect to vital jurisdictional concepts as to the nature of the tax and the incidence thereof, and has created most substantial federal questions.

(b) *Substantial federal questions are involved in the retroactive operation of the Act on income accumulated prior to date of its enactment.*

Upon the assumption that the Privilege Dividend Tax Act has any validity at all as applied to Appellant, a foreign corporation, and its non-resident stockholders, there arises a further question as to the retroactive operation of the act against the challenge that such operation violates due process under the Fourteenth Amendment of the Federal Constitution. On this question it is not enough to look at the simple transaction of declaring and receiving dividends; it is necessary to look to whatever foundation has been shoved under the tax structure to support its constitutionality, however unstable and anomalous that may be. The only ground that has been suggested to sustain the tax is the privilege granted by the State to the corporation to transact business and derive income in the state; that, it has been said, is the privilege to which the tax bears the requisite fiscal relationship. (*Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435; 85 L. Ed. 267.) In the instant case the Wisconsin court said:

> "We adhere to our determination upon remand of the *Penney* case that this is a privilege tax and that we are bound to accept the mandate of the Supreme Court that its constitutional justification from the standpoint

of Wisconsin's power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend." 243 Wis. 198, 206 10 N. W. 2d 169, 172.

Thus compelled to accept the determination of this Court, the Wisconsin court, in the instant case, pointed out that this Court by its decision had reduced the privilege of declaring and receiving dividends "to mere conditions or contingencies, on the happening of which the tax accrues." Clearly in considering the retroactive effect of the tax, the "jurisdictional fact" or "basis of Wisconsin's power to tax" is of greater importance than the "mere conditions or contingencies upon which the tax may accrue." Especially is this true when those "mere conditions or contingencies", namely, the declaration and receipt of the dividends, occur entirely outside the state.

If the State's power to tax the non-resident stockholders of a foreign corporation is to be justified by the privilege granted by the State to that corporation to derive income from the state, then under the decisions of this Court as to the permissible retroactivity of new tax laws the thrust of that tax cannot reach income earned by the corporation before the date of the enactment of the law. In *Welch* v. *Henry*, 305 U. S. 134, 83 L. Ed. 87, this Court affirmed the Wisconsin court in sustaining application of the Wisconsin income tax retroactively to "recent transactions", i. e., dividends received in a prior year. Against the objection that the tax because retroactive was a denial of due process, this court, at page 147, said:

> "In the cases in which this Court has held invalid the taxation of gifts made and completely vested before the enactment of the taxing statute, decision was rested on the ground that the nature or amount of the tax could not reasonably have been anticipated by the taxpayer at the time of the particular voluntary act which the statute later made the taxable event. * * * Since,

in each of these cases, the donor might freely have chosen to give or not to give, the taxation, after the choice was made, of a gift which he might well have refrained from making had he anticipated the tax, was thought to be so arbitrary and oppressive as to be a denial of due process."

In the instant case, on the question as to the validity of the law as applied to dividends from surplus accumulated prior to enactment of the law, the Wisconsin Supreme Court was evenly divided, one group being of the opinion that the law could not be applied to the distribution of earnings of the corporation "accrued prior to the last corporate fiscal year preceding enactment of the Wisconsin privilege dividend tax." By the tests laid down by this Court, even the retroactivity which would have been permitted by the members of the Wisconsin court just mentioned would be condemned as arbitrary and lacking due process. For the Wisconsin privilege dividend tax there was no precedent in Wisconsin law, nor, so far as we are aware, in the laws of any other state. At no time prior to the initiation of the particular legislative process could that tax have been anticipated. During the years prior to 1935, while Appellant was exercising the privilege of doing business in Wisconsin and accumulating the surplus from which the dividends in question were later paid, there was no intimation of a tax to be imposed *generally* upon residents and non-residents alike upon the *distribution* of its Wisconsin income. Indeed, there was overwhelming precedent in the decisions of the Wisconsin Supreme Court that such a tax could not constitutionally be imposed. (*Newport Co.* v. *Tax Comm.*, 219 Wis. 293; *State ex rel. Manitowoc Gas Co.* v. *Tax Comm.*, 161 Wis. 111; *Stone* v. *Tax Comm.*, 197 Wis. 71.

In the dissenting opinion in the *Penney* case, rendered by Mr. Justice Roberts, Mr. Chief Justice Hughes, Mr. Jus-

tice McReynolds and Mr. Justice Reed concurring, it was said:

> "I assume also that, where a state has, by law, fixed the conditions upon which a corporate citizen of another state may enter to transact business, she may not thereafter extend her sovereignty to matters not within her competence, in the guise of annexing other and further conditions or burdens upon the transaction of the corporation's business within her borders". P. 446.

For the privilege of doing business, granted by Wisconsin to Appellant for the years prior to the enactment of the privilege dividend tax, Wisconsin had exacted certain conditions in the way of franchise fees and income taxes. Those conditions Appellant had fully met. The privilege so granted to Appellant had ripened into vested rights, the income derived from Wisconsin business, completely discharged from all income taxes or other charges or restrictions, had been reduced to capital, had been sent outside of Wisconsin, and had become an indistinguishable part of Appellant's funds held beyond the borders of Wisconsin. There, under principles announced by this Court, Appellant's funds were "protected from legislative encroachments by constitutional guaranties." (See *Coolidge* v. *Long*, 282 U. S., 582, 603; 75 L. Ed., 562, 570.)

(c) *Substantial federal question involved in use of formula for determining basis of tax not prescribed by the Act.*

Finally, we submit that the very use of the formula adopted by the Wisconsin Department of Taxation in arriving at the basis for Appellant's tax raises a substantial federal question.

In the first place, it brings in question the very designation of the tax as an additional tax on corporate income. Mr. Justice Frankfurter, in the majority opinion in the

Penney case, used as an argument for the conclusion that the Wisconsin privilege dividend tax is in the nature of an additional tax on corporate income, that the amount of the dividend derived from Wisconsin was found by the income tax fraction. But the amount of the dividend derived from Wisconsin, in Appellant's case, is not found by the Income Tax fraction, but by an entirely different fraction, not provided for in the Wisconsin privilege dividend tax nor in the Income Tax Chapter. The Income Tax fraction is used only to obtain the portion of the *book* income of each year derived from Wisconsin, and then the Income tax formula is discarded. When a dividend is paid the amount derived from Wisconsin is allocated on a fraction found by dividing so-called Wisconsin earnings reflected in surplus by total surplus.

Yet the Wisconsin Privilege Dividend Tax Law is mandatory in its requirement that the amount of the dividend attributable to Wisconsin shall be found under the terms of Chapter 71. Under Chapter 71, there is no alternative formula provided. If the Department of Taxation cannot make a separate allocation, it must use the Income Tax fraction and no other. It has not made a separate allocation, and it has used a fraction entirely different from the Income Tax fraction, unknown to the Wisconsin Privilege Dividend Tax Act.

We submit that it is an important federal question whether a tax resulting from the application of a formula unauthorized by the Wisconsin Privilege Dividend Tax Act and unauthorized by the Wisconsin Income Tax denies the taxpayer due process of law under the Fourteenth Amendment. In the case of *Davis* v. *Wallace*, 257 U. S., 478, the United States Supreme Court held that where the formula provided by the statute could not constitutionally be applied, the taxing officers were not "at liberty to assess it on another and different basis which the statute shows

was not to be applied to corporations of the class to which these Railroad Companys belong." It added "Of course we cannot so hold." Likewise in *Oklahoma* v. *Wells Fargo & Co.*, 223 U. S., 298, Mr. Justice Holmes, writing the opinion, said that "Neither the court below nor this court can reshape the statute simply because it embraces elements that it might have reached if it had been drawn with a different measure and intent" P. 302.

The very essence of due process, particularly in the case of a tax, is governmental action under a method authorized by law. The formula devised by the Wisconsin Department of Taxation in this case is wholly unauthorized by the statute.

This Court has held that a formula resulting in allocating an excessive amount of income or of property to the taxing state denies due process of law. It would seem a fortiori that an allocation on an unauthorized formula denies due process.

We therefore submit that there is a substantial federal question whether an assessment under this formula is not a denial of due process of law under the Fourteenth Amendment.

The Manner in Which the Federal Questions Were Raised.

Judge Alvin C. Reis, of the Circuit Court for Dane County, in his written opinion in the instant case (Appendix B hereof), responding to briefs and arguments on behalf of Appellant, said:

> "The International Harvester Company is not asking us to hold simply that the statute does not apply to it. In substance, it is re-opening and submits that we are entitled to re-open the entire mooted question of the *constitutionality* of the privilege dividend tax law as affecting foreign corporations."

After referring to the conflicting decisions of this Court and of the Wisconsin Supreme Court in the *Penney* case, Judge Reis, in his opinion, made this comment:

> "We agree with counsel for the International Harvester Company that an immaculate dilemma has been created."

Upon further analysis of the conflicting decisions in the *Penney* case Judge Reis concluded:

> "Here then is the deadlock: If the tax is a transaction tax, as Wisconsin's court says it is, then it is void under the *federal* constitution; and the federal court should so hold it. If on the other hand it is an income tax, it can be an income tax only on individuals, according to the Wisconsin court, and then it becomes void under the *state* constitution; and the *state* court should so hold it."

Appellant, in its brief before the Wisconsin Supreme Court, presented with appropriate argument the following proposition:

> "II.
>
> "Taxation without jurisdiction is a denial of due process, and a privilege or excise tax cannot be levied for the privilege of doing acts which are actually done outside the jurisdiction. Such due process is guaranteed by the Fourteenth Amendment of the Federal Constitution, as well as by the Wisconsin Constitution. The Privilege Dividend Tax Law as here applied, and the taxes assessed thereunder and sustained below, violate such due process and the rights of appellant and of its stockholders under the Federal Constitution."

Appellant also presented in its brief by appropriate arguments the following propositions:

> "III.
>
> The presumption adopted in the assessment in question, namely, that the International Harvester Com-

pany paid its dividends from Wisconsin income in the proportion that its earnings from Wisconsin property and business reflected in surplus, bore to its total surplus, is wholly unauthorized by the statute."

"IV.

Where a statute provides a method of allocation and does not clearly grant to the Tax Commission authority to supply a formula in case the statutory formula proves unworkable or unconstitutional in the case of the particular taxpayer involved, the Tax Commission has no authority to supply a formula of its own. The Wisconsin Department of Taxation, therefore, has no authority to apply the formula based on surplus derived from Wisconsin."

Appellant further presented in its brief and presented with appropriate arguments the following proposition:

"V.

The State of Wisconsin cannot tax any dividend which was derived from earnings accumulated prior to September 26, 1935, when the Wisconsin Privilege Dividend Tax took effect."

The Wisconsin Supreme Court, in its decision in the instant case (Appendix A hereto), said at pages 201 and 206:

"It is contended that the privilege dividend tax contravenes the due process provision of the Wisconsin constitution and of the federal constitution; that the computation adopted by the Wisconsin Department of Taxation is not authorized by the Wisconsin dividend privilege tax law, but on the contrary, that the dividend tax law prescribes a wholly different formula; that this was not followed by the Tax Department; that Wisconsin may not tax the privilege of declaring and receiving dividends derived from earnings accumu-

lated prior to the date when the Wisconsin dividend tax took effect.

"The constitutional question considered material and decided by this Court in the original *Penney* case involved the Federal Constitution and has been answered by the Supreme Court. We consider the matter closed."

Appellant, within the time allowed, filed its motion for rehearing before the Wisconsin Supreme Court, and in its brief in support of such motion urged upon that court the following:

"If this court remains irreconcilably divided on the question whether the privilege dividend tax law is fatally retroactive, it should in any event state whether the determination of that issue involves the Wisconsin Constitution, the Federal Constitution, or both."

Appellant, in such brief in support of its motion for rehearing before the Wisconsin Supreme Court also made the following proposition with appropriate argument:

"B. The privilege dividend tax, even if otherwise valid, insofar as it operates to impose taxes on the distribution of earnings accumulated prior to date of enactment is retroactive and violative of the due process provisions of Sections 1 and 9 of Article 1 of the Wisconsin Constitution and the Fourteenth Amendment of the Constitution of the United States."

Appellant, in the same brief urged the following:

"The formula adopted by the Wisconsin Department of Taxation is a denial of due process of law."

Appellant concluded its brief on motion for rehearing with the following proposition and argument:

"The privilege dividend tax on the whole violates the due process provisions of the Wisconsin Constitution

and the Fourteenth Amendment of the Federal Constitution."

The Wisconsin Supreme Court, in its opinion denying motion for rehearing (Appendix B hereof), said:

> "In discussing the permissible retroactivity of the privilege dividend tax and noting an equal division of the court upon that point, the opinion did not indicate whether the difference in view was based upon the constitution of the State of Wisconsin, the Constitution of the United States or both. It may be useful to state that the constitutionality of the law in this respect was considered under both; and the court was of the view that the same question governed whichever constitution was applied."

It is true that in raising the question of the use of a formula not sanctioned by the statute, the Appellant did not specifically say that such use was a denial of due process under the Federal Constitution. However, it did cite two cases decided by the United States Supreme Court, *Davis* v. *Wallace, supra*, and *Oklahoma* v. *Wells Fargo & Co., supra*, each of which held that the use of an unauthorized formula was not permissible. It is true that both those cases were appeals from Federal Circuit Courts of Appeal and not from State Supreme Courts, and that the United States Supreme Court, therefore, had the whole case before it. Nevertheless, we submit that the essential ground of those decisions was manifestly that the use of an unauthorized formula is a denial of due process of law, and therefore the citation of those cases was a clear assertion by the Appellant that the Federal Due Process Clause was involved. The Trial Court and the Supreme Court of Wisconsin squarely considered the question of the use of an unauthorized formula. Moreover, Appellant did definitely raise the whole question of denial of due

process of law arising from taxation without jurisdiction and asserted that a privilege or excise tax cannot be levied for the privilege of doing acts which are actually done outside the jurisdiction. Measuring the privilege by income arising outside the jurisdiction or basing it on acts done outside the jurisdiction or measuring it by income measured by an unauthorized formula are all reasons leading to the conclusion that such a tax is taxation without jurisdiction and a denial of due process of law.

The United States Supreme Court has held that while an appellant cannot raise a new Federal question in the United States Supreme Court not raised before nor considered by the State Supreme Court, it is not confined in the United States Supreme Court to the same arguments which were advanced in the State court upon a Federal question there raised. *Dewey* v. *Des Moines*, 173 U. S., 193, 197, 198; *Keokuk & Hamilton Bridge Co.* v. *Illinois*, 175 U. S., 626, 633.

We submit that the question of the use of the unauthorized formula was definitely raised both in the trial court and the Supreme Court of Wisconsin and fully considered by those courts; that two United States Supreme Court decisions were cited which necessarily were based on Federal due process and that the whole question of denial of Federal due process by the levy of a tax without jurisdiction was raised in second Proposition quoted at page 44 above. We submit therefore that this Court has jurisdiction to consider the application of the unauthorized formula.

Cases Believed to Sustain Jurisdiction.

Appellant believes that the following cases sustain the jurisdiction of this Court:

Connecticut General Life Ins. Co. v. *Johnson*, 303 U. S., 77; 82 L. Ed., 673;

J. D. Adams Mfg. Co. v. *Storen*, 304 U. S., 307; 82 L. Ed., 1365;

Albert A. Hoeper v. *Tax Comm. of Wis.*, 284 U. S., 206; 76 L. Ed., 248;

Hans Rees' Sons Inc. v. *North Carolina*, 283 U. S., 123; 75 L. Ed., 879;

Fisher's Blend Station v. *Tax Comm.*, 297 U. S., 650; 80 L. Ed., 956.

Dated this 11th day of December, 1943.

Respectfully submitted,

JOHN A. KRATZ,
EDWARD R. LEWIS,
RAY M. STROUD,
Attorneys for Appellant,
International Harvester Company.

STROUD, STEBBINS & WINGERT,
Of Counsel.

APPENDIX "A".

WISCONSIN BOARD OF TAX APPEALS.

INTERNATIONAL HARVESTER COMPANY, a New Jersey Corporation, Petitioner,

vs.

WISCONSIN DEPARTMENT OF TAXATION, Respondent.

Decision and Order, Docket No. D-5.

This is an appeal by the petitioner from an assessment of privilege dividend taxes resulting from the respondent's audit of dividend payments made by the petitioner during the period from September 26, 1935 to October 15, 1937, inclusive.

From the stipulations presented and the record before us, we make the following findings of fact: The petitioner is a corporation organized under the laws of the State of New Jersey. Its principal office is in Hoboken. During the period under review, its general offices have been located in Chicago, Illinois. The petitioner does business in every state of the United States except Nevada. Since 1920, the petitioner has had a manufacturing plant and selling branches in Wisconsin. No directors' meetings are held in this state. The meetings at which the dividends in question were declared, and all acts and proceedings with respect to the declaration and payment of such dividends, occurred at Chicago.

Dividends on its common stock are paid in quarterly installments on the 15th day of January, April, July, and October, and dividends on preferred stock are paid in March, June, September and December.

During the period here involved, the petitioner had more than 32,000 stockholders residing in every State of the United States and many foreign countries, of whom less than 2% resided in Wisconsin.

On December 2, 1937, the respondent levied an additional assessment against the petitioner in the sum of $68,838.49, exclusive of penalties and interest. Thereafter the Wis-

consin Supreme Court, on remand from the United States Supreme Court, rendered its decision in *J. C. Penney Co. v. State of Wisconsin, et al.*, 298 N. W. 186 (reversing 233 Wis. 286). Subsequent to the decision therein, the respondent recomputed the amount of privilege dividend taxes, and under date of September 22, 1941, prepared an audit report setting forth its recomputation of the petitioner's liability for additional privilege dividend taxes. This later recomputation was supplemented by one dated November 17, 1941, in which the petitioner's separate surplus was analyzed and a computation of privilege dividend taxes made with reference to such separate surplus.

The analysis of surplus and the determination of the portion of the dividends paid by the petitioner out of its surplus attributable to Wisconsin earnings, as well as the mathematical computation of the privilege dividend taxes thereon, are not here disputed.

Following the petitioner's receipt of notice of the assessment of additional privilege dividend taxes (under date of December 2, 1937), the petitioner protested the proposed assessment and requested a hearing thereon. This appeal was pending with the Tax Commission at the time that Chapter 412, Laws of 1939, was passed, and pursuant to the provisions of that Act, the within appeal was transferred to this Board.

The following question is presented for determination: Is the method of computation employed by the respondent for the purpose of computing the privilege dividend taxes due, by virtue of Section 71.60, Section 3, upon dividends declared and paid by the petitioner out of income derived from property located and business transacted in this state, valid?

The Wisconsin statutes involved are:

Section 71.60:

> "Section 3, PRIVILEGE DIVIDEND TAX. (1) For the privilege of declaring and receiving dividends, out of income derived from property located and business transacted in this state, there is hereby imposed a tax equal to three per centum of the amount of such divi-

dends declared and paid by all corporations (foreign and local), except those specified in paragraphs (d) and (g) of subsection (1) of section 71.05 of the statutes, after the passage and publication of this act and prior to July 1, 1941. Such tax shall be deducted and withheld from such dividends payable to residents and nonresidents by the payor corporation.

* * * * * * *

"(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable to this state shall be computed in accordance with the provisions of chapter 71. In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend. If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state."

The respondent's computation of additional privilege dividend taxes is based upon the presumption that the petitioner paid its dividends from Wisconsin income in the proportion that its earnings from Wisconsin property and business, reflected in its surplus, bore to its total surplus.

The petitioner predicates its contention that the privilege dividend taxes here sought to be imposed by the respondent are invalid upon its conclusion that Section 71.60, Section 3, gives no right to this State to tax dividends from prior years' income. It further maintains that said Section grants to the State the right to tax only dividends from current income which, in the absence of proof to the contrary, is presumed to be the same as the income for the year

immediately preceding and does not permit the taxation of dividends from surplus.

Our study of the Court's decision in *J. C. Penney, supra.* (May 20, 1941) convinces us that the respondent's method of computation of additional privilege dividend taxes set forth in Exhibit 7A complies with the statutory requirements (Section 71.60, Section 3), and is in conformity with the construction of that Statute as given to it by the Wisconsin Supreme Court. The applicable portion of the decision in that case declares:

> "• • • The Wisconsin earnings and earnings for particular calendar years were not segregated and had lost their identity long before the dividends here involved were paid. It is the contention of the taxpayer that the presumption created by the statute (1) is invalid and (2) has been rebutted. The taxpayers' contention requires us to consider the nature of the presumption. By its terms it operates only in the absence of evidence. Its effect is to require the taxpayer to go forward with the evidence. When evidence is introduced which rebuts it the presumption ceases to operate because it rests upon no factual basis and takes no account of the way in which the transactions of the Company are actually handled. Being a rebuttable presumption it is clearly within the power of the Legislature to create it. Evidence having been introduced which rebuts it, the controversy must be determined upon general principles of law. It is obvious from a consideration of the facts that the so-called 'trust fund' doctrine has no application to the facts in this case. The earnings of the corporation are in no sense held by it in trust for the taxing authorities of the state. The earnings are handled according to ordinary business practice. They are not earmarked or segregated or manipulated in any manner whatever. When the corporation declared its dividends in 1936, it drew upon its net assets in excess of its capital (surplus) as required by the law of Delaware. Its net profits for the year 1935 are to be found in its surplus at the end of the calendar year. When the

Company drew upon this surplus for the payment of the dividend declared, it did not draw upon 1935 income but on its entire surplus. It must be presumed, however, that when it drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935 but to the whole amount of the surplus. * * *"

The argument advanced by the petitioner with respect to the respondent's authority to levy a tax upon dividends paid out of earnings derived prior to the effective date of the privilege dividend tax law is disposed of, in our judgment, by the decision in *J. C. Penney, supra.*

We find that the method of computation (set forth in Exhibit 7A), which the respondent used in determining the amount of privilege dividend taxes on dividends declared and paid by the petitioner out of income derived from business transacted and property located within the State of Wisconsin, is proper.

IT IS ORDERED:

That the additional assessment appealed from, as modified and amended by the recomputation of November 17, 1941, be and the same is hereby affirmed.

Dated at the State Capitol, Madison, Wisconsin, this 13th day of February, 1942.

WISCONSIN BOARD OF TAX APPEALS,
G. L. BROADFOOT,
Chairman;
W. J. CONWAY,
HARRY SLATER.

APPENDIX "B".

IN CIRCUIT COURT OF DANE COUNTY, STATE OF WISCONSIN.

INTERNATIONAL HARVESTER COMPANY, Petitioner,

vs.

WISCONSIN DEPARTMENT OF TAXATION, Respondent.

Before Hon. Alvin C. Reis, *Judge*.

Decision.

BY THE COURT:

This is an appeal from a decision and order of the Wisconsin Board of Tax Appeals assessing additional "privilege dividend" taxes against appellant for the period September 26, 1935 to October 15, 1937 in the sum (including interest and penalties) of approximately $70,000.00.

Appellant International Harvester Company is a corporation organized in 1918 under the laws of the State of New Jersey, with its principal office at Hoboken, N. J. The general offices are in Chicago.

This concern is admitted to do business in every state of the union except Nevada. Products of this corporation are nationally known and nationally sold, which is a fact of common knowledge.

No meetings of the directors of the corporation have ever been held in Wisconsin. These meetings always have been held in Chicago. It necessarily follows that the declaration of dividends by the corporation is an act which has occurred only in the State of Illinois and never in the State of Wisconsin.

Of the company's 32,000 stockholders, *ninety-eight per cent* are *non-residents* of Wisconsin, according to the stipulation filed herein.

Upon this basis, the first challenge in the pending lawsuit is to the applicability of Wisconsin's dividend tax law to this particular foreign corporation.

Literally, the statute itself does not apply.

Sec. 71.60 (3)(1) provides:

"*For the privilege of declaring and receiving dividends,* out of income derived from property located and business transacted in this state, there is imposed a tax . . . ." (Our italics).

"Declaring and receiving."

This corporation does not *declare* its dividends in Wisconsin nor do 98% of its stockholders *receive* dividends in Wisconsin.

Hence, it is argued, the statute does not apply.

Counsel for the appellant however do not expect this court to be so naive as to assume that the challenge is to the mere inapplicability of the statute. The situation in the *J. C. Penney* case was one of a foreign corporation, declaring dividends *outside* of the state to stockholders located *out* of the state. Yet in that litigation the Penney company finally was beaten.

State of Wisconsin *v.* J. C. Penney Company, 311 U. S. 435, 85 L. Ed. 267.

The International Harvester Company is not asking us to hold simply that the statute does not apply to it. In substance, it is re-opening and submits that we are entitled to re-open the entire mooted question of the *constitutionality* of the privilege dividend tax law as affecting foreign corporations.

The Supreme Court of Wisconsin, in a 6 to 1 decision, held it unconstitutional, Mr. Justice Fowler dissenting.

J. C. Penney Company *v.* Tax Commission, 233 Wis. 286.

The Supreme Court of the United States, in a 5 to 4 decision, held it constitutional, Mr. Chief Justice Hughes, Mr. Justice Roberts, Mr. Justice McReynolds and Mr. Justice Reed dissenting.

State of Wisconsin et al. *v.* J. C. Penney Company, 311 U. S. 435, 85 L. Ed. 267.

The majority opinion of the Wisconsin court was written by Mr. Chief Justice Marvin B. Rosenberry.

The majority opinion of the United States court was written by Mr. Justice Felix Frankfurter.

Upon remand from the court at Washington, the Supreme Court of Wisconsin again considered the nature and application and constitutionality of the tax. Mr. Chief Justice Rosenberry again wrote the opinion, which this time was unanimous.

J. C. Penney Company *v.* Tax Commission, 238 Wis. 69.

We agree with counsel for the International Harvester Company that an immaculate dilemma has been created.

In the first *Penney* case the Supreme Court held the tax to be a transaction tax or tax on "privilege", as in terms it so states; and since the transaction happened and the privilege was exercised outside of Wisconsin, in the case of a foreign corporation such as this one, the Wisconsin court held the tax unconstitutional, being violative of due process.

When however this case reached the Supreme Court of the United States, that tribunal regarded this tax as a "supplementary income tax" upon the corporation and hence clearly within the power of the state to impose and not infringing upon the fourteenth amendment.

In the third and final round of the battle thus far, i. e., remand from the United States Supreme Court to the Wisconsin court, our local court followed the United States Supreme Court upon the issue of constitutionality *because it had to do so.* That pitches a delicate point rather abruptly but no one will question the accuracy of our assertion.

The Supreme Court of Wisconsin however, in this last decision, refused to recede from its former position that this was an excise or privilege tax. It militantly maintained that it was its right, and its alone, to say what this tax was; and that such was not the province of the Supreme Court of the United States. And thereupon and in the face of the highest federal court declaration that the tax here involved was a "supplementary income tax" upon the corporation, the Wisconsin court unequivocally de-

clared: "*In no sense and to no extent whatever, is it a tax upon the income of the corporation.*" (Our italics.)

J. C. Penney Company *v.* Tax Commission, 238 Wis. 69 73.

We can not settle this dispute. That rests far beyond our hands.

The Wisconsin court insists that the tax is a transaction tax, which under the federal constitution makes it unconstitutional because based on out-of-state transactions. But the United States court majority opinion disregards it as a transaction tax and sets the tax up as an additional corporate income tax, the validity of which is obvious.

The Supreme Court of Wisconsin, as noted, however, will not accept it as an income tax on the corporation. Furthermore, it postulates that if it is an income tax on individuals, it is unconstitutional *under the state constitution*, because the individuals are beyond the jurisdiction of Wisconsin to tax.

"It is perfectly true that the tax cannot be sustained as an income tax under the law of this state."—Thus spoke our own Supreme Court.

J. C. Penney Company *v.* Tax Commission, 238 Wis. 69, 72.

Therefore, as an income levy, the tax is completely *persona non grata* in this state—an unwanted black sheep in the Wisconsin court's backyard.

Here then is the deadlock: If the tax is a transaction tax, as Wisconsin's court says it is, then it is void under the *federal* constitution; and the federal court should so hold it. If on the other hand it is an income tax, it can be an income tax only on individuals, according to the Wisconsin court, and then it becomes void under the *state* constitution; and the state court should so hold it.

One living *fact* however sticks out in this mesh of speculation and expectation and of controversy: And that existing fact controls the Circuit Court for Dane County until the time, if any, when one of the higher courts changes its conclusion as to what this law is.

That salient fact is that both courts—federal supreme and state supreme—*so far* hold the law to be valid.

Whatever may be the refinements of difference as to meaning or designation of the tax, and serious as may be the clash of legal conceptions that *ultimately* may destroy it, the record thus far indicates that the tax must be accepted by lower courts as a valid tax, even as against a foreign corporation declaring its dividends out of the state to stockholders out of the state.

The Supreme Court of the United States *reversed* the decision of the Supreme Court of Wisconsin which had held the tax unconstitutional. That is the record in the federal court.

The Supreme Court of Wisconsin, upon remand, regardless of its frank and emphatic disagreement with the United States court upon the theory of the tax, concludes succinctly:

"It is held that the statute is valid; that the State of Wisconsin has jurisdiction to levy the tax * * *"

J. C. Penney Company *v.* Tax Commission, 238 Wis. 69, 79.

The next ground for the appeal herein is the alleged unsoundness of the method employed by the Department of Taxation, sustained by the Board of Tax Appeals, in computing the tax. To adopt appellant's own construction of what respondent have done: "Basically in the computation of the tax as affirmed by the Board of Tax Appeals, the Department has attempted to analyze the surplus on the December 31st of the year preceding the year in which a particular dividend is paid, in an alleged attempt to determine the percentage of Wisconsin income in surplus at that time." (Appellant's brief, pp. 5-6.)

Sec. 71.60 (3) (4) reads:

"(4) In the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only to dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin. The amount of income attributable

to this state shall be computed in accordance with the provisions of chapter 71. *In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend.* If a corporation had a loss for the year prior to the payment of the dividend, the tax commission shall upon application, determine the portion of such dividend paid out of corporate surplus and undivided profits derived from business transacted and property located within the state." (Our italics.)

Appellant argues that it has successfully shown that dividends were not paid out of *earnings* attributable to Wisconsin for the immediately preceding year but rather out of its general surplus. Hence, the presumption stated in the foregoing statutory clause, is said to be rebutted; and plainly it is.

The question, as we see it, then becomes: If the presumption of payment out of preceding year's earnings is rebutted, what test may or must the Department of Taxation apply?

Certainly it is not intended that there shall be a gap and that if the presumption is rebutted, there shall be no tax. Yet this in essence is the effect of appellant's argument. Incidentally, it strikes us that the legislature has proceeded with artificiality in making the basic assumption that dividends customarily are paid out of earnings of the immediately preceding year. We had thought that ordinarily they were paid out of surplus. In predicating the presumption that dividends are paid out of one year's earnings, namely those of the year most recently past, rather than out of the accumulated surplus—unless proven to the contrary—the legislators have visualized the cart before the horse; but perhaps for reasons sufficient to themselves.

Appellant's objection herein is that, the presumption being frustrated, our tax authorities went ahead and determined the portion of the dividend paid out of surplus

derived from Wisconsin (using the surplus figure as of the close of the preceding fiscal year). This, it is pointed out, is the method prescribed by 71.60 (3) (4) for a *loss;* and appellant contends that there being no loss but, on the contrary, a profit, then—under the maxim, *enumeratio unius est exclusio alterius*—the tax people have done just what the legislature inferentially said they could not do in the case of a profit.

This presents a fascinating problem, were it not for the circumstance that the Supreme Court of Wisconsin has given sanction to the formula utilized by the Department of Taxation. With that sanction before us, we can not very well pick the mechanics to pieces for theoretical reasons.

Upon remand in the *Penney* case, the Supreme Court said (J. C. Penney *v.* Tax Commission, 238 Wis. 69, 78-79):

"When the corporation declared its dividends in 1936, it drew upon its net assets in excess of its capital (surplus) as required by the law of Delaware. *Its net profits for the year 1935 are to be found in its surplus at the end of the calendar year. When the company drew upon this surplus for the payment of the dividend declared, it did not draw upon 1935 income but on its entire surplus. It must be presumed, however, that when it drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935 but to the whole amount of the surplus.* The Tax Commission treated the matter as if the statutory presumption were conclusive and gave no weight or consideration to the evidence. In this the Tax Commission was in error. It is said in briefs of counsel that it would be a Herculean task to compute the amount of surplus attributable to Wisconsin income. Inasmuch as the basis upon which the Supreme Court of the United States sustained the tax is that some part of the dividend is allocable to Wisconsin income, we see no escape from the conclusion that no tax can be levied until that fact is ascertained." (Our italics.)

That the Department of Taxation in the present case has acted in pursuance of Mr. Chief Justice Rosenberry's analysis, is not and can not be disputed by appellant.

On page 11 of the brief by appellant's attorneys, they say: "There is no such thing as a Wisconsin surplus. It is therefore a gratuitous assumption, unwarranted under the statute, to declare that when the company pays a dividend, it draws on Wisconsin earnings in the proportion that Wisconsin earnings reflected in surplus bear to its total surplus."

On page 4 of the reply brief by appellant's attorneys, they say: "The only manner in which it can be said that the dividend, which was actually paid out of surplus, was partially paid out of Wisconsin earnings reflected in surplus is to adopt a new fiction in lieu of the rebutted statutory fiction."

These comments might constitute a well-deserved rebuke to the Department of Taxation, were it not for the fact that the opinion of Mr. Chief Justice Rosenberry, evidently concurred in by all the justices, points the way to what appellant calls the "unwarranted" assumption and "new fiction".

If the merits need be considered, which they need not, since the Chief Justice and the court have spoken:

Why is it not completely logical to state, as Mr. Chief Justice Rosenberry did, that when the corporation drew upon surplus containing Wisconsin income, it drew upon Wisconsin income to the extent of the proportion of that income to the whole amount of the surplus?

Moreover, as we have intimated, if this foundation is not built upon, then upon what can the Department of Taxation construct any tax whatever? And surely because a presumption is rebutted, it should not be contemplated that the bottom drops out of the tax bucket.

We repeat: Appellant's position renders the whole dividend tax nugatory. Bluntly its attorneys state (p. 7, reply brief): "Finally, there is not a word in the statute which says that a dividend paid out of surplus can be taxed. The

statute provides for taxing only dividends paid out of income."

If this is the end result of Wisconsin's dividend tax law, then that law is a dead letter, not only as to foreign corporations *but as to domestic corporations as well,* which declare dividends out of surplus. And we know that corporation do declare dividends out of surplus. A second-year law school student knows that. The law of corporations just about requires it, both as to a New Jersey corporation such as appellant and as to a Wisconsin corporation.

Section 14:8-19, Revised Statutes of New Jersey 1937, provides:

"*The directors of a corporation shall not pay dividends except from its surplus,* including surplus as determined by section 14: 8-6 of this title, or from the net profits arising from the business of the corporation. * * *" (Our italics.)

Sec. 182.19 (1), Wisconsin statutes, reads:

"No dividend shall be paid by any corporation until at least fifty per cent of the authorized capital stock has been fully paid in, *and then only out of net profits properly applicable thereto* * * *"

We grant that appellant has an academic argument to the effect that it has rebutted the presumption that dividends were paid out of the preceding year's earnings and that the statute does not call for a tax on dividends declared out of surplus, *eo nomine.*

But in that event, what was the sense in carrying the issue of *constitutionality* in the first *Penney* case to the Supreme Court of the United States? The whole matter could have been stopped in its tracks by a decision of the Wisconsin court that the statute does not tax dividends declared out of surplus.

What was the purpose of the Supreme Court of Wisconsin in the second *Penney* case in sending the case back to the Department of Taxation for a re-computation, if the law does not tax a dividend declared out of surplus? Our

Supreme Court knew that the dividend of J. C. Penney Company was declared out of *surplus*. The entire second phase of its opinion was devoted to that very proposition. (238 Wis. 69, 74-79.)

To now propound, as appellant does, that a dividend out of surplus is not taxable at all, is to accuse the legislature of futility and the Supreme Court of a glaring oversight.

Appellant's incidental criticism in this regard is that the Department of Taxation should not have used surplus *as of December 31st* of the year preceding. Appellant submits directors' resolutions which purportedly recognize something in the form of a current or daily surplus, e.g., "surplus account at April 15, 1937."

This approaches the hyper-critical. Common business sense dictates that surplus figures may be taken as of the close of the year. One cannot mark a surplus sheet like the milk man's morning card.

Finally, appellant protests of the retroactivity of the computation. That is, this surplus is an accrual from the year 1918. It can not be segregated as to time. *Ergo*, says appellant, this surplus allocation method must be erroneous to the extent that it presupposes surplus accretions *before* Wisconsin's dividend tax law ever went into effect, which was September 26, 1935. Erroneous, because, appellant argues, the taxpayer had met all of Wisconsin's requirements as to income earned prior to that date and could not constitutionally have thrust upon it an additional burden upon that income—citing the dissenting opinion of Mr. Justice Roberts in the *Penney* case.

This argument is a throw-back to the original dilemma herein described. If the tax is geared to income, then it is arguable that we are faced with a prodigiously retroactive income tax. On the other hand, if the tax is a transaction tax, then the argument mis-fires; for the *transaction* is a present one, to-wit, the immediate declaration of the dividend; and the hoary surplus is but one component in the equation by which to gauge the final quantum of the tax.

We respectfully leave that residuum of the dilemma where it belongs: To our colleagues on the Supreme Court of Wisconsin and the Supreme Court of the United States.

The Attorney General may prepare and submit to appellant's attorneys the order and judgment affirming the decision and order of the Board of Tax Appeals.

Dated August 14, 1942.

IN SUPREME COURT OF STATE OF WISCONSIN

AUGUST TERM, 1943

JANUARY, 1943 CALENDAR

No. 56

INTERNATIONAL HARVESTER COMPANY, *a New Jersey Corporation, Petitioner and Appellant*

v.

WISCONSIN DEPARTMENT OF TAXATION, *Respondent.*

Wickhem, J. on re-hearing:

The court has thoroughly considered the motions for rehearing filed herein and is not disposed to modify its views or to restate or amplify its opinion in any respect but one. In discussing the permissible retroactivity of the privilege dividend tax and noting an equal division of the court upon that point, the opinion did not indicate whether the difference in view was based upon the constitution of the state of Wisconsin, the constitution of the United States of America, or both. It may be useful to state that the constitutionality of the law in this respect was considered under both; and the court was of the view that the same considerations governed whichever constitution was applied.

By the court—Motion for re-hearing is denied, with $25 costs.

APPENDIX "C"

IN SUPREME COURT OF STATE OF WISCONSIN

JANUARY TERM, 1943

No. 56

INTERNATIONAL HARVESTER COMPANY, *a New Jersey Corporation, Petitioner and Appellant*

v.

WISCONSIN DEPARTMENT OF TAXATION, *Respondent.*

This is an appeal from an order and judgment of the Circuit Court for Dane County, Alvin C. Reis, Circuit Judge. Affirmed.

Appeal to the Circuit Court for Dane County from an order of the Wisconsin Board of Tax Appeals which had affirmed an additional assessment of privilege dividend taxes against appellant, International Harvester Company, a New Jersey Corporation. The order of the Wisconsin Board of Tax Appeals was dated February 13, 1942 and the order and judgment of the Circuit Court was made and entered on September 17, 1942. The material facts will be stated in the opinion.

WICKHEM, J.:

Appellant is a New Jersey corporation, having its principal office in Hoboken, New Jersey. Its general executive offices are in Chicago. So far as the record discloses, it has done business in Wisconsin since 1920. The Wisconsin dividend privilege tax law was enacted and went into effect on September 26, 1935. From December 2, 1935 to October 15, 1937 appellant paid numerous dividends totalling $39,028,188.22, but did not pay any privilege dividend tax thereon. As of the end of the year 1934, the amount of surplus accumulated from Wisconsin earnings and constituting Wisconsin surplus on the basis of the for-

mulae and method of computation prescribed by chapter 71 was $803,780.72. The amount attributable to Wisconsin as of December 31, 1935 was $2,227,449.03. The Wisconsin surplus as of October 31, 1936 was $2,608,908.26. On December 2, 1937 the Wisconsin Tax Commission, predecessor of Wisconsin Department of Taxation, notified appellant of an assessment of privilege dividend tax against it in the amount of $68,838.49, exclusive of penalties and interest, computation being based upon the statutory presumption that such dividends were paid out of previous years' earnings. Subsequently thereto, and because of the conceded rebuttal of the presumption, respondent recomputed the privilege dividend tax at $53,713.29, exclusive of penalties and interest. There is a stipulation to the effect that, assuming the law to be valid and the method of computation authorized, the amount of the privilege tax as computed is correct. The contentions made by appellant all present matters of constitutional law and statutory construction. It is contended that the privilege dividend tax contravenes the due process provision of the Wisconsin constitution and of the federal constitution; that the computation adopted by the Wisconsin Department of Taxation is not authorized by the Wisconsin dividend privilege tax law, but on the contrary, that the dividend tax law prescribes a wholly different formula; that this was not followed by the Tax Department; that Wisconsin may not tax the privilege of declaring and receiving dividends derived from earnings accumulated prior to the date when the Wisconsin dividend tax took effect.

This case is another chapter in a long history of litigation concerning the dividend tax law during which this court has passed upon the constitutionality of the law and its proper construction three times, and the United States Supreme Court has considered these matters once. *Froedtert G. & M. Co.* v. *Tax Comm.*, 221 Wis. 225, 265 N. W. 672, 267 N. W. 52; *J. C. Penney Co.* v. *Tax Comm.*, 233 Wis. 286, 289 N. W. 677; *Wisconsin* v. *Minn. Mining & Mfg. Co.*, 311 U. S. 452; *J. C. Penney Co.* v. *Wisconsin*, 238 Wis. 65, 298 N. W. 186, (upon remand).

The controversy has developed into a battle of words and labels and it may be of service to review the litigation and ascertain just what has been authoritatively determined. On September 26, 1935 the privilege dividend tax [1] went into effect and for purposes of reference so much of it as is material here is set forth in the notes. The constitutionality and construction of this law was put in issue in *Froedtert G. & M. Co.* v. *Tax Comm.*, (supra) and this court there held that it levied a tax upon the privilege of transferring from the corporation to the stock holders corporate net income derived from corporate business transacted, or property located in Wisconsin. That case involved a Wisconsin corporation, but upon rehearing, it was stated without elaborate discussion that the tax was constitutional as applied to the dividends of foreign corporations. The matter again came before this court in *J. C. Penney Co.* v. *Tax Comm.*, 233 Wis. 286, 289 N. W. 677, and it was there held that in its application to a foreign corporation doing business in Wisconsin and deriving a portion of its surplus from net earnings in Wisconsin, the law was an unconstitutional attempt by Wisconsin to tax a privilege which it neither gave nor protected, and that Wisconsin was consequently without jurisdiction to levy the tax. This court relied principally on the case of *Connecticut Gen. Ins. Co.* v. *Johnson*, 303 U. S. 77, where upon facts that appeared to us to be quite indistinguishable the Supreme Court of the United States had held California to be without jurisdiction to levy a privilege tax, and in doing so, had said:

"But the limits of the state's legislative jurisdiction to tax, prescribed by the Fourteenth Amendment, are to be ascertained by reference to the incidence of the tax upon its objects rather than the ultimate thrust of the economic benefits and burdens of transactions within the state."

Upon appeal to the United States Supreme Court, judgment in the *Penney* case was reversed by a divided Court. It was held that the practical operation of the legislation is

[1] Reporter will publish sec. 71.60, statutes of 1941, section 3 (1), (2), (3) and (4), as a foot note.

to impose an additional tax upon corporate earnings with Wisconsin, but to postpone the liability for this tax un such earnings are paid out in dividends.

"In a word, by its general income tax Wisconsin tax corporate income that is taken in; by the Privilege Di dend Tax of 1935 Wisconsin superimposed upon this i come tax a tax on corporate income that is paid out."

After noting that the act specifically levies the tax up the privilege of declaring and receiving dividends, th the taxpayer is a Delaware corporation with its princip offices and meeting place in New York, and that this cou has held the tax to be one upon a transaction wholly b yond Wisconsin's borders or reach, the Court said:

"The case thus reduces itself to the inquiry wheth Wisconsin has transgressed its taxing power because i supreme court has described the practical result of th exertion of that power by one legal formula rather than a other—has labeled it a tax on the privilege of declarin dividends rather than a supplementary income tax.

"A tax is an exaction. 'Ascertainment of the scope the exaction—what is in included in it—is for the sta court. But the descriptive pigeon-hole into which a sta court puts a tax is of no moment in determining the co stitutional significance of the exaction * * *."

"* * * For constitutional purposes the decisive issue turn on the operating incidence of a challenged tax. A state free to pursue its own fiscal policies, unembarrassed by th Constitution, if by the practical operation of a tax the sta has exerted its power in relation to opportunities which has given, to protection which it has afforded, to benefi which it has conferred by the fact of being an orderl civilized society."

"Constitutional provisions are often so glossed ov with commentary that imperceptibly we tend to constru the commentary rather than the text. We cannot, how ever, be too often reminded that the limits on the othe wise autonomous powers of the states are those in the Co stitution and not verbal weapons imported into it. 'Ta able event,' 'jurisdiction to tax,' 'business situs,' 'extra territoriality,' are all compendious ways of implying th

impotence of state power because state power has nothing on which to operate. These tags are not instruments of adjudication but statements of result in applying the sole constitutional test for a case like the present one. That test is whether property was taken without due process of law, or, if paraphrase we must, whether the taxing power exerted by the state bears fiscal relation to protection, opportunities and benefits given by the state."

Upon remand to determine such questions as were left open by the opinion of the Supreme Court, this court in *J. C. Penney Co.* v. *Tax Comm.*, 238 Wis. 69, 298 N. W. 186 (1) insisted upon its exclusive power to construe the law; (2) held the law to be a privilege tax and not an income tax; (3) held that the determination of the United States Supreme Court settled all questions as to the jurisdiction of Wisconsin to levy the tax, whatever it be called, and (4) made certain directions as to its computation. The latter point need not be elaborated in this portion of the opinion. From the briefs in this case, and the memorandum of the trial court it appears to be concluded that we have here what the trial court designates an "immaculate dilemma"; that the Supreme Court of the United States has held this to be an income tax and that as such, it is invalid under the Wisconsin constitution; that the Supreme Court of Wisconsin, upon remand has persisted in designating it a privilege tax in which case the privilege being wholly exercised outside of the state, it is unconstitutional under the federal constitution.

We see no such dilemma. As we read the opinion of the United States Supreme Court, we discover no attempt by the court to usurp the function of this court so far as construing or labeling this tax is concerned. What the Supreme Court has done is (1) to state the factual basis upon which this law must be treated as constitutional insofar as the jurisdiction of Wisconsin to levy it is concerned and (2) to hold that given the factual basis, the law is constitutional in this aspect, regardless of the designation given it by this court. In other words, the federal Supreme Court has established the jurisdictional fact which is that the corporation paid the dividends in whole or in part out of

property located in this state, or business transacted here. If the term "jurisdictional fact" must hereafter be relegated to the limbo of outmoded terms, the basis of Wisconsin's power to tax is the fact that it has given its protection and the benefits of government to corporate activities in Wisconsin and that profits from this activity are traceable to the fund from which dividends are paid. So far as the constitutional aspects of the cases are concerned, the Supreme Court has reduced the privilege features of the tax to mere conditions or contingencies, upon the happening of which the tax accrues.

This being true, we perceive no conflict so long as we are talking about the power of Wisconsin to tax as against the contention that the subject of the tax is beyond her borders, and hence, beyond her jurisdiction. It makes no difference what this court calls the tax. It may, for other than constitutional reasons, be important to designate the tax a privilege tax, but the label has no bearing upon the controversy here. We adhere to our determination upon remand of the *Penney* case that this is a privilege tax and that we are bound to accept the mandate of the Supreme Court that its constitutional justification from the standpoint of Wisconsin's power to tax is the fact of net earnings in Wisconsin traceable to the fund distributed by the dividend. Under the circumstances, we do not propose to re-examine contention heretofore made and impliedly overruled that the law is void under the Wisconsin constitution. The constitutional question considered material and decided by this court in the original *Penney* Case involved the federal constitution and has been answered by the Supreme Court. We consider the matter to be closed.

The next question has to do with the application and computation of the tax, and in connection with this a constitutional question is raised having to do with its retrospective operation and not litigated or involved in the previous litigation. From even a casual reading of the privilege dividend tax, it is clear that the legislature meant to levy it upon the paying out and receiving of dividends out of net corporate earnings in Wisconsin, without regard to the year or years during which the earnings accrued. Sub-

section 3 of section 71.60 Stats. provides without qualification that the tax shall be levied for the privilege of declaring and receiving dividends out of income derived from property located and business transacted in this state. Subsection 3(4) provides "in the case of corporations doing business within and without the state of Wisconsin, such tax shall apply only on dividends declared and paid out of income derived from business transacted and property located within the state of Wisconsin." (Income attributable to this state to be computed in accordance with the provisions of chapter 71.)

"* * * In the absence of proof to the contrary, such dividends shall be presumed to have been paid out of earnings of such corporation attributable to Wisconsin under the provisions of chapter 71, for the year immediately preceding the payment of such dividend * * *"

This merely creates a rebuttable presumption that all of the dividend was paid out of Wisconsin earnings for the year immediately preceding the payment of the dividend. It is finally provided that if the corporation had a loss for that year the commission, upon application, is to determine the portion of such dividend paid out of surplus and undivided profits derived from business transacted, and property located within the state. There is no time limit anywhere unless the reference to the presumption be tortured into some sort of limitation of the tax to dividends paid out of the previous years' earnings and this would be a disingenuous construction. The section strongly suggests that the legislature had no misgivings as to its power to reach Wisconsin earnings without regard to the time of their accrual by a tax on the privilege of paying and receiving dividends effecting their distribution.

Upon the question whether, so far as it purports to reach Wisconsin earnings without reference to the year in which they were earned, the section is unconstitutionally retroactive in application, the Court is equally divided.

Mr. Justice Fowler, Mr. Justice Fritz and Mr. Justice Fairchild are of the view (1) that since this is a privilege tax on transactions by which dividends are declared and paid subsequent to the enactment of the statute, the tax is

prospective and not retroactive in operation when it is imposed on only such of those transactions as occurred in the year in which it is imposed; (2) that the prospective character of the tax is not affected by the fact that in assessing the amount thereof,—which under the statute is to be limited to the extent that income earned in Wisconsin was used in paying the dividend in such year,—there was included undistributed income earned theretofore in Wisconsin; and (3) that these conclusions are in accord with the decision of this court upon remand in the *Penney* Case.

Mr. Chief Justice Rosenberry, Mr. Justice Martin and the writer are of the view (1) that since the United States Supreme Court has held that the label placed upon this law by the legislature or by this court is wholly ineffective to impair its constitutionality as against the contention that Wisconsin is without power to levy the tax, such label or designation or the selection by Wisconsin of the payment and receipt of the dividend as the occasion for the tax is equally ineffective to save it from objections to its retroactivity; (2) that the earnings of the corporation in Wisconsin upon which are grounded Wisconsin's power to levy the dividend tax must be within reach of a retroactive tax; (3) that the extent of permissible retroactivity should be determined upon the analogy of the income tax cases; (4) that retroactivity should only be permitted to "recent" transactions; (5) that consistently with these principles the tax may not be applied to earnings in Wisconsin which accrued prior to the last corporate fiscal year preceding the enactment of Wisconsin privilege dividend tax; (6) that by reason of the severability clause, the operation of the tax should be so limited; (7) that nothing in the decision upon remand requires a different conclusion.

The court being equally divided, this results under the rules of this court in an affirmance of the judgment upon this point.

The rest of this case we consider to have been authoritatively settled by the decision of this court in the *Penney* Case upon remand. The law requires that the commission assess the tax upon the presumption that the dividend was paid out of Wisconsin earnings for the year preceding the

declaration of a dividend. Upon rebuttal of this presumption, a tax may be levied upon such portion of the dividend as is represented by Wisconsin earnings, these to be ascertained by application of the formula prescribed in Chapter 71. The proportion between the sum so arrived at and the total assets available for dividends establishes the percentage of the dividend attributable to Wisconsin earnings. In the *Penney* Case upon remand this Court said:

"• • • When the corporation declared its dividends in 1936, it drew upon its net assets in excess of its capital (surplus) as required by the law of Delaware. Its net profits for the year 1935 are to be found in its surplus at the end of the calendar year. When the company drew upon this surplus for the payment of the dividend declared, it did not draw upon 1935 income but on its entire surplus. It must be presumed, however, that when it drew upon the surplus which contained Wisconsin income, it drew upon Wisconsin income to the extent of the proportion which Wisconsin income bore not to the income for the year 1935 but to the whole amount of the surplus • • •"

In making this statement it was not intended to create an artificial rebuttable presumption comparable to that created in sub-section (4) of the dividend tax act. What the court meant to hold and what we do hold is that in this situation there is a strong, if not inevitable inference to the effect noted; In other words, that the conclusion not only can be arrived at by ordinary methods of reasoning without dependence upon a judicially created presumption, but that it cannot be avoided by any evidence that we have presently in mind.

It is contended that since the statute contains no specific formula for computing the tax, this Court cannot supply one. We deem this contention unsound. If by any process reasonably calculated to accomplish the result, the amount of Wisconsin earnings involved in the declaration sought to be taxed may be ascertained the validity of the law is not impaired by the absence of detailed specifications concerning computation. The formula for ascertaining the amount of net earnings allocable to Wisconsin

is set forth in chapter 71 and the validity of this formula is well established. There is a strong if not inevitable inference that these earnings became (1) part of the general assets available for distribution as dividends, and (2) part of the dividend declared in the proportion that they bear to the total assets available for dividends. We do not deem it necessary that there shall have been a formal transfer of earnings into a surplus account. While the statutes of New Jersey, and we suppose those of nearly every state, require that dividends be paid out of surplus, the sense in which surplus is used means excess of assets over liabilities, including capital. This concern of the law as laid down by decisions and prescribed by statutes is that dividends shall not be declared out of capital. If Wisconsin earnings have gone to swell the assets of the corporation in such a way as to create an excess of assets over liabilities, and to authorize a dividend, the Wisconsin earnings are proportionately a part of this excess, whatever it be called. The formula prescribed by this court upon remand in the *Penney* Case, that is, that the Wisconsin earnings should constitute the numerator of a fraction of which the entire amount available for dividends is the denominator, is rational and workable and was applied in this case. While we recognize the force of objection that can be made to any determination reached in this matter, the foregoing conclusions are the only ones that will accommodate themselves to premises which we must accept.

By the Court.—Order and judgment are affirmed.

APPENDIX "D".

IN SUPREME COURT, STATE OF WISCONSIN

JANUARY TERM, 1943

Nos. 38, 39, 40, 41

No. 38

WISCONSIN GAS & ELECTRIC COMPANY, *Petitioner and Appellant,*

v.

WISCONSIN DEPARTMENT OF TAXATION, *Respondent.*

No. 39

WISCONSIN ELECTRIC POWER COMPANY, *Petitioner and Appellant,*

v.

WISCONSIN DEPARTMENT OF TAXATION, *Respondent.*

No. 40

WISCONSIN MICHIGAN POWER COMPANY, *Petitioner and Appellant,*

v.

WISCONSIN DEPARTMENT OF TAXATION, *Respondent.*

No. 41

THE MILWAUKEE ELECTRIC RAILWAY AND LIGHT COMPANY, *Petitioner and Appellant,*

v.

WISCONSIN DEPARTMENT OF TAXATION, *Respondent.*

Appeals from orders of the Circuit Court for Dane County. August C. Hoppmann, Judge. *Affirmed.*

These were appeals by Wisconsin Gas & Electric Company, Wisconsin Electric Power Company, Wisconsin Mich-

igan Power Company and The Milwaukee Electric Railway and Light Company, pursuant to section 73.015 Stats. to the Circuit Court for Dane County from orders of the Wisconsin Board of Tax Appeals dated November 16, 1939 to the effect that appellants are not permitted by the terms of section 71.03 (4) Stats. to deduct from gross income privilege dividend taxes on dividends declared and paid out of net earnings during 1936. On September 14, 1942 the trial court entered orders affirming decisions dated November 16, 1939 of the Wisconsin Board of Tax Appeals. From these orders the taxpayers appeal.

WICKHEM, J.:

The taxpayers are public service corporations. The privilege dividend tax involved in this case has to do with the income year 1936 in the case of The Milwaukee Electric Railway and Light Company, Wisconsin Electric Power Company, Wisconsin Gas & Electric Company, and that of 1938 of the Wisconsin Michigan Power Company. The situation in respect of the first three companies named is different from that of the last in that the first three companies withheld the privilege dividend tax from the shareholders, whereas Michigan Power Company paid out the dividends and absorbed the tax itself. The contention of the taxpayers is that privilege dividend taxes are deductible from gross income because they are taxes on necessary business and corporate activities. Sec. 71.03 (4) Stats. authorizes the following deductions from the gross income of the corporation:

"Taxes other than special improvement taxes paid during the year upon the business or property from which the income tax is derived, including therein taxes imposed by the state of Wisconsin and the government of the United States as income, excess or war profits and capital stock taxes. • • •"

Article 507, Regulations of the Tax Commission, provides:

"In general, only taxes, other than special improvement taxes, paid during the year upon the business or property

from which the income tax is derived, may be deducted from gross income."

Article 507.5 of the same regulations read:

"Import or tariff duties and business, license, privilege, excise, and stamp taxes, are deductible if incurred in connection with the operation of the taxpayer's trade or business."

Article 520 of such Regulations declares:

"Fees for transferring and registering capital stock are deductible, since such expenses are necessary and related to the production of taxable income."

In the Uniform Classification of Accounts for Electric Utilities prescribed by the Railroad Commission, effective January 1, 1923, operating expenses are thus defined:

"The term operating expenses, as used in this classification, means such expenses as are necessary to the maintenance of the corporate organization, the rendering of service required or authorized by law. * * *"

Included in this classification is a paragraph on other than miscellaneous general expenses and this includes dividend notices, fees of transfer agents, and registrar of stock.

From all the foregoing, taxpayers contend that a tax upon the privilege of declaring dividends is one upon the corporation and constitutes a duty and necessary expense of doing business. Reliance is had upon the case of *J. C. Penney Co.* v. *Wisconsin*, 311 U. S. 435 to the effect that the tax is the return asked for the substantial privilege of carrying on corporate business in Wisconsin, although conditioned upon happenings outside the borders of the state. It is further contended that since the tax wholly depends upon corporate action, it cannot be treated as levied upon the income of shareholders; that it must be paid by the corporation out of earnings otherwise available for distribution.

We are favored with able briefs addressed to the question whether this is a tax upon the corporation, in which case it

is assumed that it must be regarded as an expense of doing business deductible from gross income, or whether it is a tax upon the stockholder. We are not at all sure that all of this argument does not (to paraphrase the opinion of the Supreme Court in the *Penney* case) amount to glossing over the provisions of the statute with commentary and then construing the commentary rather than the text. The real question in this case is: on whom is the actual burden of this tax laid? This question can have but one answer. The statute specifically puts it upon the stockholder. The corporation is directed to deduct the tax from the dividends and if it does as it is required to do, it sustains no expense and consequently may not, in any event, deduct the tax from its gross income. It is contended that the foreign stockholder of a foreign corporation has done no business in Wisconsin for which the tax may validly be levied. This contention was foreclosed when the Supreme Court of the United States sustained the power of Wisconsin to levy this tax. It made its determination with the statute before it—a statute that plainly puts the burden of this tax upon the stockholder and not upon the corporation. So far as Wisconsin's power to reach beyond its borders and to levy the tax is concerned, the Supreme Court has declared that Wisconsin has the right to exact the tax because of protection given to corporate activities in this state resulting in earnings traceable to the dividends declared and benefits to the stockholder who has received a dividend. At this state of the litigation we are not concerned with the question of the power to tax and we must assume that the power vindicated is the power to levy the very tax that was before the Supreme Court for consideration. That power having been sustained, regardless of what the tax be called or where its burdens may be considered to fall, it is immaterial that the Supreme Court has not merely regarded the privilege features of the tax as unimportant but has to some extent disregarded the corporate entity in view of the real benefits conferred by the state upon the stockholder. We are certain of three things: (1) that the burden of the tax is specifically laid upon the stockholder; (2) that the corporation declaring the dividend must deduct the tax from the dividend and may not under any circumstances treat the tax

as a necessary expense of doing business; (3) that the power to levy the tax so construed was authoritatively established in the *Penney* case. It follows that appellants' contentions must fail.

By the Court.—The orders in each case are affirmed.

APPENDIX "E".

IN SUPREME COURT, STATE OF WISCONSIN,

January Term, 1943.

No. 109

FRANK C. BLIED, Plaintiff and Appellant,

v.

WISCONSIN FOUNDRY AND MACHINE COMPANY, a Wisconsin Corporation, Defendant and Respondent.

Filed June 16, 1943. Arthur A. McLeod, Clerk of Sup. Court, Madison, Wisconsin.

This is an appeal from a judgment of the Circuit Court for Dane County, Alvin C. Reis, Circuit Judge. *Affirmed.*

Action by Frank C. Blied, plaintiff, against Wisconsin Foundry and Machine Company, a Wisconsin corporation, defendant, brought on November 3, 1942 by plaintiff in his own right, and on behalf of others similarly situated, to recover an amount withheld by defendant corporation from preferred stock dividends and paid to State of Wisconsin on account of Wisconsin dividend privilege taxes pursuant to chapter 505, laws of 1935, as amended. Defendant interposed a general demurrer to plaintiff's complaint. On December 12, 1942, judgment was entered sustaining a general demurrer and dismissing plaintiff's complaint. The material facts will be stated in the opinion.

WICKHEM, J.:

Plaintiff, a Wisconsin resident, was the owner of cumulative preferred stock, issued by defendant. The stock was purchased in 1942 with the provision that there would be paid thereon preferential cumulative dividends at the rate of $5.50 per share during such time as the stock should be outstanding, payable out of net profits or surplus applicable thereto, as and when declared by the directors of the defendant. Respondent's principal place of business is the city of Madison and its income is wholly derived from profits and business transacted in the state of Wisconsin. In 1942 defendant declared two semi-annual dividends, each at the rate of $2.25 per share, payable April 1st and October 1st, respectively. Subsequent to each declaration, defendant deducted from the amount of dividend so declared and payable an amount equal to 3% thereof, representing the Wisconsin privilege dividend tax imposed by section 3, chapter 505, Wisconsin Laws of 1935 as amended. In doing this, defendant relied upon the literal provisions of the statute, and asserted that the privilege dividend tax is against the stockholder in respect of the privilege of receiving dividends.

Plaintiff's contentions are that while the language seems to place the tax on the stockholder it must be ignored in view of the fact (1) that the corporation alone is made liable for the tax, (2) that the corporation alone is made liable for the penalty and interest on failure to pay the tax. (3) that no personal liability is imposed upon the stockholder.

It is contended that the United States Supreme Court in *Wisconsin* v. *J. C. Penney Co.*, 311 U. S. 435 construed the tax as one upon corporate earnings and held that the basis of the tax is the privilege to the corporation of doing business in this state. It is further contended that if construed to be one upon the stockholders, the tax is unconstitutional and void because no privileges were conferred by Wisconsin upon the stockholders who are not residents of the state and have neither done business in the state nor declared the dividends which are taxed.

The contentions in this case are identical with those dealt with in *Wisconsin Gas & Electric Company* v. *Wisconsin Department of Taxation; Wisconsin Electric Power Company* v. *Wisconsin Department of Taxation; Wisconsin Michigan Power Company* v. *Wisconsin Department of Taxation; The Milwaukee Electric Railway and Light Company* v. *Wisconsin Department of Taxation*, and the views of the court are sufficiently set forth in the opinion filed in those cases. The decision in *Wisconsin Gas & Electric Company* v. *Wisconsin Department of Taxation; Wisconsin Electric Power Company* v. *Wisconsin Department of Taxation; Wisconsin Michigan Power Company* v. *Wisconsin Department of Taxation; The Milwaukee Electric Railway and Light Company* v. *Wisconsin Department of Taxation* requires that the judgment in this case be affirmed, since the specific requirements of the statute which we hold to be valid are that the tax be withheld and deducted from the dividend payable to a stockholder,

By the Court.—Judgment affirmed.